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October 28. 2011

BY HAND-DELIVERY

Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street. SW
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ENTERED
Office of Proceedings

OCT 31 2011

Part of
Public Record

Re: Western Coal Traffic League—
Petition for Declaratory Order,
STB Finance Docket No. 35506

Dear Ms. Brown:

Enclosed for filing in the above-referenced proceeding are an original and ten copies of the Public version of the Opening Evidence and Argument of BNSF Railway Company. Also enclosed is a CD that contains the Public version in PDF format. Please note that this filing includes color images.

We are also filing under separate cover a Highly Confidential version of the Opening Evidence and Argument of BNSF Railway Company.

Please date-stamp the enclosed extra copy of the Public version and return it to our representative. Thank you.

Sincerely yours,

Robert M. Jenkins III

RMJ/bs

Enclosures

231207

**PUBLIC VERSION**
**CONTAINS COLOR IMAGES**

**BEFORE THE**
**SURFACE TRANSPORTATION BOARD**

OCT 28

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**FINANCE DOCKET NO. 35506**

**WESTERN COAL TRAFFIC LEAGUE—**
**PETITION FOR DECLARATORY ORDER**

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# OPENING EVIDENCE AND ARGUMENT OF BNSF RAILWAY COMPANY

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Dated: October 28, 2011

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# OPENING EVIDENCE AND ARGUMENT OF BNSF RAILWAY COMPANY

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Pursuant to the decision of the Surface Transportation Board ("STB" or "Board") served September 28, 2011, in the above-captioned proceeding ("Decision"), BNSF Railway Company ("BNSF") files here its opening evidence and argument. Attached in support of BNSF's argument are the verified statements of Thomas N. Hund, Executive Vice President and Chief Financial Officer of BNSF, and Michael R. Baranowski and Benton V. Fisher, Senior Managing Directors of FTI Consulting, Inc.

## Introduction

BNSF was acquired by Berkshire Hathaway Inc. ("Berkshire") on February 12, 2010. As required by Generally Accepted Accounting Principles ("GAAP"), Securities and Exchange Commission ("SEC") reporting requirements, and the STB's Uniform System of Accounts ("USOA"), BNSF's net investment base was adjusted using GAAP-based purchase accounting requirements to record the transaction. In this proceeding, Western Coal Traffic League ("WCTL") asks the Board to issue an order that would exclude the write-up in BNSF's net investment base attributable to the GAAP purchase accounting adjustment and to make corresponding changes in BNSF's annual depreciation calculations under the Uniform Rail

Costing System ("URCS"). The Board in its Decision also sought comments on the effects of using GAAP purchase accounting for revenue adequacy purposes. Slip op. at 2-3.

The issue of excluding from the STB's books and URCS costing the "acquisition cost" of a railroad purchased in a merger or acquisition is not new, and neither are the arguments that WCTL makes for why acquisition cost should be excluded. The use of acquisition cost, as prescribed by GAAP, to value a railroad's assets has long been settled—both by the STB and by its predecessor, the Interstate Commerce Commission ("ICC"). WCTL has pointed to no change in circumstances that could justify revoking that settled regulatory requirement and applying a different standard to Berkshire's acquisition of BNSF.

The STB and the ICC have not been alone in prescribing the use of acquisition cost to value a railroad's assets in the wake of a merger or acquisition. The Railroad Accounting Principles Board ("RAPB") thoroughly considered the issue and determined that acquisition cost should be used, regardless of whether that cost was above or below the book value of the railroad before the transaction. Two different federal circuit courts of appeal also reviewed the question and upheld the use of acquisition cost.

Significantly, the STB, the ICC, the RAPB, and the courts have specifically addressed the very same URCS objections to acquisition cost raised by WCTL in its petition. They have also addressed concerns about the impact of acquisition cost on revenue adequacy. And they have determined repeatedly that none of those concerns provides a legitimate ground for departing from GAAP purchase accounting to establish the economic value of a railroad's assets and liabilities. Further, they have emphasized that the ICC's and STB's use of acquisition cost is consistent with Congress's statutory mandate at 49 U.S.C. §§ 11161 and 11142 that the agency rely on GAAP accounting for regulatory purposes "to the maximum extent practicable."

Mr. Hund explains in his verified statement how BNSF and Berkshire—working with two major accounting firms, Ernst & Young ("E&Y") and Deloitte & Touche—implemented GAAP purchase accounting for both SEC and STB reporting purposes. Messrs. Baranowski and Fisher explain the regulatory effects of the purchase accounting write-up of BNSF assets in its R-1 Annual Report to the STB, and they compare these effects to those in prior rail merger and acquisition transactions.

The accounting for Berkshire's acquisition of BNSF does differ from the many prior merger and acquisition transactions where the STB and the ICC have required GAAP accounting to value railroads' assets and liabilities. First, in those transactions most or all of the acquisition cost was allocated to the railroads' net investment base for regulatory purposes. Baranowski/Fisher VS at 5. In BNSF's case, however, the application of GAAP purchase accounting resulted in only $8 billion of the $22 billion premium that Berkshire paid over book value being allocated to BNSF's assets and liabilities. The rest, $14 billion, was allocated to goodwill[1] and other items that do not affect regulatory cost. That $14 billion has no impact on the value of BNSF's assets for economic regulatory purposes or its URCS costs. Hund VS at 6-7; Baranowski/Fisher VS at 2.

Furthermore, *none* of the acquisition premium paid by Berkshire over the pre-acquisition market price of BNSF is included in the value of BNSF's assets for regulatory purposes. On the day that Berkshire agreed to acquire BNSF, BNSF's stock was trading at $76 per share. That was significantly more than the $38 book value of BNSF's shares. Thus, the market had already decided that BNSF's value as a company greatly exceeded the book value of its equity. Berkshire paid $100 per share. Every dollar paid by Berkshire in excess of the $76 per share

[1] Goodwill for the Berkshire transaction is $15 billion, which is offset by $1 billion of net liabilities not affecting BNSF Railway's regulatory costs.

market value was attributed to goodwill, so none of that excess affected the value of BNSF's assets for regulatory purposes. Hund VS at 6-7.

BNSF's policy and practice is to set transportation rates on the basis of market demand, not regulatory costs, so the purchase accounting adjustments to BNSF's investment base will not result in increases to BNSF's rates. There will be an effect on the Board's calculations of BNSF's URCS costs and on revenue adequacy, but that effect will be modest. Baranowski/Fisher VS at 5-9. Only one of the thousands of BNSF customers currently has a prescribed transportation rate that is directly affected—Western Fuels Association, Inc./Basin Electric Power Cooperative, Inc. ("WFA/Basin")—and that unique circumstance can be addressed in WFA/Basin's ongoing rate case with BNSF.

Most importantly, acquisition cost, as implemented by GAAP purchase accounting, has been repeatedly found to be the most economically valid and practical method for the STB to use to carry out its regulatory responsibilities. WCTL has pointed to no changed circumstance that could justify a different result here. The Board should not deviate from its consistent and unambiguous adherence to GAAP purchase accounting with respect to Berkshire's acquisition of BNSF.

## I. THE STB, THE ICC, THE RAPB, AND THE COURTS HAVE CONSISTENTLY AND UNAMBIGUOUSLY APPLIED ACQUISITION COST TO VALUE RAILROADS' ASSETS AFTER A MERGER OR ACQUISITION

The principles of GAAP purchase accounting are well-established and widely accepted. As explained by Mr. Hund in his Verified Statement, GAAP rules provide the foundation for consistent and comparable financial reporting in the United States. Purchase accounting is required under GAAP and is used by virtually all businesses in the United States, including

railroads, to adjust their books after a merger or acquisition to reflect the purchase price for the business. Hund VS at 2-3.

Berkshire and BNSF followed the same principles in preparing their books after Berkshire's acquisition of BNSF that they and other businesses follow every day in accounting for business transactions. There is nothing out of the ordinary regarding their use of GAAP accounting. Virtually every Class I railroad merger or acquisition that has taken place in the past two decades has involved an "acquisition premium," and in every instance the ICC or the STB has endorsed the carrier's use of acquisition cost, in accordance with GAAP rules, to account for the transaction. Indeed, the agency is required by its own rules to use GAAP purchase accounting for regulatory purposes. *See* 49 C.F.R. Part 1201, General Instructions 2-15(c).

The issues presented by WCTL's petition are not new. They have been thoroughly analyzed in multiple agency and court proceedings, and for over two decades the answer has been the same: Acquisition cost, as prescribed and implemented by GAAP, is the appropriate measure of the economic value of a railroad's assets for URCS and revenue adequacy purposes after a merger or acquisition. Proponents of an exception for Berkshire's acquisition of BNSF bear a heavy burden, which they cannot carry, of demonstrating why the STB should reach a different conclusion here.

### A. The Acquisition Cost Principle, As Implemented by GAAP, Has Been Consistently Applied

The ICC's and the STB's consistent use of GAAP purchase accounting for mergers and acquisition transactions is rooted in the Interstate Commerce Act and good regulatory policy. At one time, the ICC permitted exceptions to the use of acquisition cost for some regulatory purposes. Although the USOA has long required the use of GAAP accounting, including acquisition cost accounting in mergers and acquisitions, the ICC periodically entertained requests

for exceptions—typically when a railroad had been purchased for *less* than its book value.[2] That ended in the late 1980s as a result of Congressional action and thoroughly considered agency policy.

In the Staggers Rail Act of 1980 ("Staggers Act"), Congress added a new Subchapter IV to Chapter III of Title 49, entitled "Railroad Cost Accounting." The original Sections 11161-63 established the RAPB, with a specific mandate:

> [The RAPB] shall establish . . . principles governing the determination of economically accurate railroad costs directly and indirectly associated with particular movements of goods, including the variable costs associated with particular movements of goods or such other costs that the [RAPB] believes most accurately represent the economic costs of such movements. Such principles shall govern the determination of all railroad costs for specific regulatory proceedings under this title.

49 U.S.C. § 11162(a). Upon the RAPB's establishment of those principles, the ICC was required to "promulgate rules to implement and enforce such principles." 49 U.S.C. § 11163. The ICC was further authorized to promulgate rules "prescribing expense and revenue accounting and reporting requirements consistent with [GAAP] uniformly applied to such carriers." 49 U.S.C. § 11166.

Pursuant to Congress's mandate, the RAPB was funded in 1984 and held lengthy proceedings regarding the best principles for determining both practicable and economically accurate railroad costs. The RAPB concluded, among other things, that the use of GAAP accounting for railroad mergers and acquisitions represented the superior method for measuring

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[2] *See, e.g.*, Ex Parte No. 439, *Railroad Revenue Adequacy—1981 Determination*, not printed (served Nov. 18, 1982).

economically accurate costs. RAPB Final Report, Volume 2—Detailed Report (Sept. 1, 1987) ("RAPB Report"), at 46-47.[3]

Following issuance of the RAPB Report, the ICC conducted a notice-and-comment proceeding specifically addressed to the acquisition cost issue. As recommended by the RAPB, the ICC adopted a uniform rule requiring the use of acquisition cost regardless of whether that cost was above or below book value. *Railroad Revenue Adequacy—1988 Determination*, 6 I.C.C.2d 933, 935-42 (1990) ("*Revenue Adequacy—1988*"). While the RAPB and the ICC were conducting their proceedings, Rio Grande Industries, Inc. acquired Southern Pacific Transportation Company in a major merger transaction. Rio Grande paid substantially less than the book value of Southern Pacific. The ICC applied GAAP purchase accounting to substantially write *down* the value of Southern Pacific's assets and expenses for regulatory purposes. *Rio Grande Industries, Inc.—Control—Southern Pac. Transp. Co.*, 4 I.C.C.2d 834, 980 (1988) ("*Rio Grande*").

The Association of American Railroads and other railroad interests appealed the ICC's decision in *Revenue Adequacy—1988*, arguing that GAAP purchase accounting should not be uniformly applied to write down a railroad's assets for regulatory purposes following a merger or acquisition transaction. The D.C. Circuit rejected that appeal, finding that the ICC's decision to uniformly apply GAAP purchase accounting was both rational and lawful. *Assoc. of Amer. RR's v. ICC*, 978 F.2d 737, 741-43 (D.C. Cir. 1992) ("*AAR*").

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[3] For the Board's convenience, a copy of pertinent sections of the RAPB's Final Report is attached hereto. The RAPB's issuance of its Final Report concluded its statutory mission. In the ICC Termination Act of 1995, Congress removed most of the provisions of Subchapter IV of Chapter III of Title 49 concerning the RAPB, renumbered the remaining sections, and required in what is now Section 11161 that the newly established STB conform its cost accounting rules to GAAP to the "maximum extent practicable."

From the late 1980s, the ICC and then the STB consistently applied the acquisition cost principle to value railroads' assets after a merger or acquisition. This included many significant transactions in which the purchase price was above book value. The first was the acquisition of Chicago and North Western Transportation Company by Blackstone Capital Partners L.P. in 1989.[4] Subsequently, Burlington Northern Railroad Company merged with The Atchison, Topeka and Santa Fe Railway Company,[5] Union Pacific Railroad merged with Southern Pacific Transportation Company,[6] CSX Transportation Company and Norfolk Southern Railway Company acquired and split between them the assets of Consolidated Rail Corporation,[7] and Canadian National Railway Company acquired Illinois Central Railroad Company.[8]

These were all major transactions involving proceedings in which hundreds of parties participated. Everyone was given full opportunity to raise any concerns they had about the transaction, and the ICC and STB extensively considered those concerns. In only *one* of those transactions did a party argue that the purchase accounting write-up in the railroad's asset base should be excluded from the railroad's R-1 Report for regulatory purposes. In *Conrail*, shipper interests advanced the same arguments as shipper interests in this proceeding, contending that the

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[4] *See Blackstone Capital Partners L.P.—Control Exemption—CNW Corporation and Chicago and North Western Transp. Co.*, 5 I.C.C.2d 1015 (1989) ("*Blackstone*").

[5] *See Burlington Northern R.R. Co.—Control and Merger—Santa Fe Pac. Corp. and The Atchison, Topeka and S.F. Ry. Co.*, 10 I.C.C.2d 661 (1995) ("*BN/SF*").

[6] *See Union Pac. Corp.—Control and Merger—Southern Pac. Rail Corp.*, 1 S.T.B. 233 (1996) ("*UP/SP*").

[7] *See CSX Corp.—Control—Conrail, Inc.*, 3 S.T.B. 196 (1998) ("*Conrail*").

[8] *See Canadian National Ry. Co., Et Al.—Control—Illinois Central Corp., Et Al.*, 4 S.T.B. 122 (1999) ("*CN/IC*").

STB should exclude the impact of purchase accounting and require the use of the old book value ("predecessor cost") for URCS and revenue adequacy purposes.

The STB fully analyzed and rejected that argument, concluding that acquisition cost represented the best evidence of the value of the acquired Conrail properties for regulatory purposes. *Conrail*, 3 S.T.B. at 262-65. Shipper organizations appealed the STB's decision. The Second Circuit rejected the appeal, concluding that the STB's decision was well-supported. *Erie-Niagara Rail Steering Comm. v. STB*, 247 F.3d 437, 442-43 (2d Cir. 2001) ("*Erie-Niagara*").[9]

Shipper interests tried in one other proceeding, STB Ex Parte No. 582 (Sub-No. 1), *Major Railroad Consolidation Procedures* ("*Consolidation*"), to have the STB change its well-established requirement that acquisition cost, as implemented by GAAP purchase accounting, be

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[9] After the *UP/SP* merger, WCTL filed a complaint against UP seeking an order directing UP in its annual R-1 Report to identify as "unusual or infrequent" or as "special charges"—to be excluded from UP's URCS costs—certain expenses UP incurred in connection with its merger with SP and in connection with service problems experienced in 1997 and 1998. *Western Coal Traffic League v. Union Pacific Railroad Co.*, 4 S.T.B. 685 (2000). WCTL argued that UP's treatment of those expenses as ordinary expenses violated GAAP and the Board's USOA. The Board found no merit in WCTL's complaint. *Id.* at 686-95. The Board rejected a similar claim in *FMC Wyoming Corp. and FMC Corp. v. Union Pacific Railroad Co.*, 4 S.T.B. 699 (2000). As the Board summarized:

> Our Uniform System of Accounts (USOA) expressly provides, at 49 C.F.R. 1201, Instruction 2-15(c)(1), that when an acquisition results from a purchase (including mergers or consolidations other than pooling of interests), the amount to be included in Account 731, Road and Equipment Property, shall be the cost to the purchaser of the transportation property acquired. The USOA also provides that liabilities assumed by the purchaser, including restructuring costs incurred by the acquired carrier in anticipation of consolidation, are a part of the cost of acquiring the company. UP followed the explicit provisions of the USOA in its treatment of the SP liabilities. . . . As we explain more fully in WCTL, expenses of this sort are properly included in the URCS variable cost computation . . . as a normal part of railroad operations. [4 S.T.B. at 709.]

used to determine a railroad's costs and net investment after a merger or acquisition transaction. The STB once again rejected their arguments for excluding purchase accounting adjustments from the railroads' R-1 Reports and from URCS, concluding that "there is no sound economic justification" for valuing properties obtained through a merger based upon predecessor book values rather than acquisition cost. Slip op. at 28, 2001 WL 648944, *18 (served June 11, 2001).

### B. Proponents Of Applying Different Accounting Principles To Berkshire's Acquisition Of BNSF Bear A Heavy Burden

In this proceeding, WCTL has asked the Board to decline the application of GAAP purchase accounting for regulatory costing purposes to Berkshire's acquisition of BNSF. WCTL Pet. at 1. It is unclear from WCTL's petition whether it seeks to amend the USOA as applied to all mergers and acquisitions or to restrict its request for relief to Berkshire's acquisition of BNSF. On the one hand, WCTL does not claim that BNSF failed to comply with the USOA, and its complaints about the application of GAAP purchase accounting to BNSF's books are generally applicable to any merger or acquisition transaction in which the acquisition cost exceeds book value. At the same time, WCTL does not propose any amendments to the USOA, and its petition cites 5 U.S.C. § 554 as authority for this proceeding, which deals with agency adjudications, rather than 5 U.S.C. § 553, which deals with agency rulemaking proceedings.

Insofar as WCTL is seeking to amend the USOA, BNSF submits that this is the wrong proceeding for that.[10] Under the Board's regulations, the Board's rules can only be amended in a

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[10] As the STB observed in *Conrail*:

> The statute specifically limits our rate regulation to situations where the rate exceeds 180% of variable cost of service, and the statute also directs that we conduct our costing in accordance with GAAP to the maximum extent practicable. *See* 49 U.S.C. 10707(d)(1)(A) and 49 U.S.C. 11161 (accounting). The relief that protestants are requesting would seem to contravene these specific

rulemaking proceeding. *See* 49 C.F.R. § 1110.1 (the Board's rulemaking procedures "apply to the issuance, amendment, and repeal of rules, general policy statements, or other interpretations of rules or law of the Surface Transportation Board, adopted under the procedures of section 553 of title 5 of the United States Code (the Administrative Procedure Act)").[11]

Insofar as WCTL is seeking to carve out an exception to the use of acquisition cost for URCS costing or revenue adequacy calculations, its petition must fail. The ICC's and the STB's position on the use of acquisition cost for both URCS costing and revenue adequacy calculations is well-established and has been reiterated repeatedly for over two decades.[12] As a general matter, any long-established regulatory position cannot be altered without a very persuasive explanation. The agency must be able to demonstrate that the reasons that motivated its prior holdings no longer hold, either because they were deficient in the first place or because a change in circumstances has altered its previous calculus. *See, e.g., Motor Vehicle Manufacturers Ass'n of the United States v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 41-42 (1983).

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> statutory directives. *Even if we were inclined to consider a basic change in our accounting rules, it would not be appropriate to do so for these applicant carriers alone in the context of this transaction.*

3 S.T.B. at 264 (emphasis added).

[11] *Cf. Alabama Power Co. v. FERC*, 160 F.3d 7, 10-11 (D.C. Cir. 1998) (vacating a Commission decision regarding a utility's accounting practices because the decision constituted a rule and the Commission failed to comply with rulemaking procedures).

[12] As STB Chairman Elliott explained in a March 28, 2011 letter to Senator Al Franken:

> [S]ince the late 1980s the agency has required railroads to follow purchase accounting principles, in accordance with Generally Accepted Accounting Principles (GAAP). The stated objective of the regulations requiring adherence to GAAP was to ensure that the railroads use the most accurate information about fair market value in reporting on their rail assets.

There has been no change in circumstances, however, that justifies any different result for Berkshire's acquisition of BNSF than for the Rio Grande/Southern Pacific, Blackstone/North Western, Burlington Northern/Santa Fe, Union Pacific/Southern Pacific, CSX/Norfolk Southern/Conrail, or Canadian National/Illinois Central transactions. Two federal circuit courts of appeal have confirmed that the ICC's, the RAPB's, and the STB's decisions adopting and applying the acquisition cost principle for revenue adequacy and URCS costing purposes were and are correct. Neither GAAP purchase accounting rules nor the STB's implementation of those rules through the USOA has changed.

Further, the STB is constrained here by Congress's statutory mandate. Congress established the RAPB for the express purpose of developing accounting principles for the agency's use. *See* Staggers Act, 49 U.S.C. §§ 11161-63. This places a special burden on proponents of a "predecessor cost" principle to justify the STB deviating from the principles adopted by the RAPB. In addition, the statute expressly requires that the STB conform its cost accounting rules to GAAP "to the maximum extent practicable." 49 U.S.C. § 11161. There is no doubt that the application of the acquisition cost principle is practicable. It has been used in every merger or acquisition transaction for over two decades, and it has been consistently applied for URCS costing and revenue adequacy purposes.

In sum, proponents of applying a different accounting standard to Berkshire's acquisition of BNSF bear a heavy burden, which they cannot carry. Berkshire and BNSF applied GAAP purchase accounting to their transaction, just as required by the USOA, and WCTL has not offered any reason why their transaction can or should be excepted from the USOA, or why URCS costing or revenue adequacy calculations for BNSF should be performed any differently than they are for other railroads.

## II. NONE OF THE REASONS SUGGESTED BY WCTL FOR EXCEPTING BNSF FROM THE STB'S WELL-ESTABLISHED USE OF GAAP PURCHASE ACCOUNTING FOR REGULATORY PURPOSES HAS ANY MERIT

The reasons advanced by WCTL in its petition for not applying GAAP purchase accounting to Berkshire's acquisition of BNSF are not new, and they have no more merit today than they did in the past. As the ICC and the STB have repeatedly found, there is no "unfairness" involved in using the same GAAP accounting standards for mergers and acquisitions that the STB uses generally for valuing a railroad's assets. Insofar as practicable, regulatory costing aims to be economically accurate, and acquisition cost represents the best evidence of the current value of a railroad's assets and liabilities. If an individual shipper can point to a situation in a particular case where the use of GAAP does not produce an economically appropriate result under the standards governing that dispute, that shipper can seek relief in that case. But this is not such a case.

WCTL's reliance on authority applicable to other regulatory regimes is misplaced. As every relevant authority has confirmed, the "circularity" problem in heavily regulated industries is not an issue in the rail industry, where prices are largely determined by market demand. Furthermore, the practical regulatory impact of applying acquisition cost here is modest. Only $8 billion out of the $22 billion premium Berkshire paid is included in BNSF's investment base. The percentage increase in BNSF's investment base is smaller than in virtually every one of the merger and acquisition transactions where the STB has uniformly applied GAAP purchase accounting for URCS and revenue adequacy purposes over the past two decades.

### A. There Is No "Unfairness" Involved In Using Economically Accurate Costs

#### 1. The Goal Of The STB's Regulatory Costing System Is To Practicably And Accurately Reflect A Railroad's Actual Costs

The RAPB, the ICC and the STB have all repeatedly held that GAAP purchase accounting represents the best combination of economic accuracy and practicality. The RAPB in particular distinguished between GAAP "historical cost," which updates the value of a business's assets based upon specific transactions, and "predecessor cost," which freezes the value of assets at their original cost levels. The RAPB concluded that for revenue adequacy and regulatory costing purposes, a transaction-based historical cost system, supported by well-defined GAAP principles, was the best model. RAPB Report 40-43, 59-60.

The ICC, the STB, and the RAPB unanimously agreed that, following a merger or acquisition, a railroad's old book value no longer reflects its current value, and acquisition cost should be used to establish new asset values. RAPB Report at 45-48 ("The use of acquisition (or GAAP) cost better represents the economic conditions facing the enterprise than does predecessor cost.") In *Conrail*, the STB concluded that the purchase price agreed to by commercially sophisticated railroads represented by far the best evidence of the current value of the involved properties. *Conrail*, 3 S.T.B. at 265. In the *Major Railroad Consolidation Procedures* rulemaking, the STB concluded that "there is no sound economic justification" for valuing properties obtained through a merger based upon predecessor book values rather than acquisition cost. *Consolidation*, slip op. at 28, 2001 WL 648944, *18.

#### 2. BNSF's R-1 Report Reflects An Appropriate Valuation of BNSF's Assets

WCTL premises its argument against the use of GAAP accounting for Berkshire's purchase of BNSF on the notion that it is "fundamentally unfair" for URCS variable costs to be

set at higher levels "simply because Berkshire decided to pay a substantial acquisition premium in purchasing BNSF." WCTL Pet. at 5. This ignores that the fundamental determinant of fair value and economic costs in our economic system is what a willing buyer pays a willing seller. As the STB has recognized, neither Berkshire nor any other rational investor pays any more for a business than what it believes the business is worth. *Conrail*, 3 S.T.B. at 265. And GAAP accounting properly uses the price paid as the starting point for establishing the value of the company going forward.[13]

Under GAAP, not all of the purchase cost of the business is necessarily allocated to individually identifiable assets and liabilities. As Mr. Hund explains, GAAP recognizes that an ongoing business entity may have a value over and above the value of its identifiable assets and liabilities, which is called "goodwill." Accordingly, when purchase accounting is used to value a business, a determination must be made of how much of the value of the company is attributable to its identifiable assets and liabilities and how much to goodwill. Hund VS at 3-4. Significantly, for STB regulatory purposes, none of the value of the company attributable to goodwill is included in the asset values reported in a railroad's R-1 Reports or used in the STB's URCS costing or revenue adequacy calculations. Baranowski/Fisher VS at 2.

As described by Mr. Hund, in the case of Berkshire's acquisition of BNSF, the allocation of the purchase price between BNSF's assets and liabilities was determined with significant input from E&Y, one of the Big Four accounting firms. E&Y conducted a rigorous review of

[13] As Mr. Hund explains, GAAP requires purchase accounting under rules codified by the Financial Accounting Standards Board in Accounting Standards Codification (ASC) 805. For any acquisition, the purchase price for a company must be allocated to the assets and liabilities of the company at their "fair value" as of the transaction date. ASC 820 defines "fair value" as the price that would be received to sell an asset or paid to transfer a liability between market participants in an arms' length transaction. Any excess of the purchase price over the "fair value" of the assets and liabilities is allocated to an intangible asset called "goodwill." Hund VS at 3.

BNSF's physical and intangible assets and liabilities to determine a "fair value" of the assets and liabilities in accordance with ASC 805. E&Y's work was then audited by a second of the Big Four accounting firms, Deloitte & Touche. The result was that of the $22 billion that Berkshire paid above the book value of BNSF, only $8 billion was allocable to BNSF's assets and liabilities impacting BNSF's regulatory costs, while $14 billion was allocable to goodwill and other items that do not affect regulatory cost. In other words, for regulatory purposes, the value of BNSF's assets was increased by approximately a third of the total premium above book value that Berkshire paid for BNSF. Hund VS at 6-8.

It is important to recognize that the term "acquisition premium" can have two different meanings. WCTL in its petition defines it as the difference between the book value and the purchase price of the acquired assets. WCTL Pet. at 1 n.1. As Mr. Hund explains, however, stock value is what most people use as their barometer of the day-to-day financial worth of a company. Hund VS at 3. Thus, in finance terms, an "acquisition premium" is the amount paid by a purchaser above the market price of company—as reflected in the share price—on the date the purchase deal is struck. If a company is purchased for its per share market price, no premium at all was paid for the company.[14]

As explained by Mr. Hund, Berkshire paid $100 per share to acquire BNSF at a time when BNSF shares were trading at the market price of $76 per share. That represented an acquisition premium above the market price of $24 per share. (If BNSF's share value tracked the book value of its equity, the share price would have been $38 per share. In other words, long before Berkshire's agreement to purchase BNSF, the market had already determined that

[14] In the *Conrail* proceeding, the STB noted that the term "acquisition premium" was used by some of the protesters to describe "the difference between the Conrail share price before the acquisition and at the time of the acquisition." 3 S.T.B. at 261 n.93.

BNSF's value as a going concern greatly exceeded its book value.) Hund VS at 6-7. *None* of that $24 per share acquisition premium above BNSF's share price is reflected in the 2010 R-1 values of BNSF's assets and liabilities used for URCS costing and revenue adequacy purposes. All of that premium and more is attributed to goodwill and other items that do not affect regulatory cost, under the GAAP purchase accounting adjustments made by BNSF. *Id.*

In contrast, in the *Conrail* proceeding, where the STB thoroughly evaluated the URCS costing and revenue adequacy concerns of the protestants, Conrail's stock price had risen from $71 to $115 as a result of the competitive bidding between NS and CSX. *Erie-Niagara*, 247 F.3d at 442. That represented a premium above the market share price of $44 per share. The STB determined that there was no "unfairness" in valuing the assets the two railroads acquired at their full purchase price for revenue adequacy and URCS costing purposes, because it represented "the best evidence by far of the current value of the impacted properties." *Conrail*, 3 S.T.B. at 265. As the Second Circuit summarized the STB's position, with approval:

> [T]he price paid was not excessive because the actual purchase price of a rail asset, negotiated at arm's length, best reflects the asset's actual value. Accordingly, the difference between i) the book value of Conrail's assets or original market value of its stock and ii) the purchase price of Conrail is not a premium above actual value; rather it simply demonstrates that the actual value of Conrail had previously been underestimated.

*Erie-Niagara*, 247 F.3d at 442.

Applying the logic of the STB and the reviewing court, the purchase price for BNSF also demonstrated that the actual value of BNSF as an ongoing business had previously been underestimated by the market, and that BNSF's book value even further understated BNSF's current value. Still, under the purchase accounting approach, much of that value was attributed to net assets that do not affect regulatory costs, primarily goodwill. As detailed in Mr. Hund's statement, in making the purchase accounting adjustments, BNSF's and Berkshire's experts used

a rigorous process that included reviewing the physical condition of the hard assets and looking for synergistic opportunities with regard to the overall network. In the valuation process, an optimized network was planned and assessed by E&Y and BNSF, so that only the productive capacity of the BNSF rail network was considered in establishing the new book value for property, plant and equipment. Hund VS at 4-5.

As a result of this approach, some of BNSF's assets were written up in value and some down. Mr. Hund describes the results of that process in his statement. For example, the optimized system treated over 6600 route miles as duplicative and assigned no value to those assets. On the assumption that some of BNSF's signal assets would be rendered obsolete by Positive Train Control, certain of those assets were written down. At the same time, much of the grading and real property on BNSF's system, which dates back to the 1800s, was written up in value. *Id.*

The "fair value" calculations were also affected by the timing of the transaction at a low point in the economic cycle, which further reduced the value of some hard assets. As an example, some assets, such as locomotives, were written down because they were determined to be excess (non-productive) on the acquisition date. The combined impact of the optimized system approach and the timing of the valuation in the economic cycle was that less of the purchase price was allocated to the physical assets and more to goodwill. *Id.*

The bottom line is that BNSF's current R-1 Report allocates to BNSF's regulatory investment base only approximately a third of the amount that Berkshire paid over BNSF's old book value. Indeed, as a percentage of BNSF's old book value, the increase in BNSF's investment base attributable to the Berkshire transaction is less than virtually every one of the transactions involving other railroads over the past two decades where the purchase prices

exceed the book values of the assets. And all of these transactions were booked for regulatory purposes under the GAAP acquisition cost principle. *See* Baranowski/Fisher VS at 5.

### B. WCTL's Reliance On Authority Applicable To Other Regulatory Regimes Is Misplaced

WCTL in its petition argues that the STB should not use acquisition cost to adjust railroads' books after a merger or acquisition because the Federal Energy Regulatory Commission and other public utility commissions do not permit it. WCTL Pet. at 6-8 and n.7. This is not a new argument. In fact, in every proceeding where a party has questioned the ICC's or STB's use of acquisition cost, rather than predecessor cost, on its regulatory books, that party has argued that the use of predecessor cost should be required because of a "circularity" problem that has been recognized by agencies and courts in other regulatory contexts. The argument is that an increase in a regulated utility's investment base necessarily results in higher rates, which in turn elevates the value of the business.

In every proceeding, the ICC, the STB, the RAPB, and the courts have rejected this argument. The RAPB found that the circularity problem did not exist in the rail industry because rail rates are determined by competitive market forces, not GAAP costs. RAPB Report at 46-47. The ICC found the same, and the D.C. Circuit specifically affirmed the ICC's position. *Revenue Adequacy—1988*, 6 I.C.C.2d at 938-39; *AAR*, 978 F.2d at 442-43. In *Conrail*, the STB once again held that there was no "circularity" problem with using acquisition costs for regulatory purposes in the rail industry, and the Second Circuit agreed. *Conrail*, 3 S.T.B. at 262; *Erie-Niagara*, 247 F.3d at 442-43.

Nothing has changed in the rail industry to cause the STB to reverse over two decades of consistent holdings by the agency, the RAPB, and the courts on this issue. WCTL suggests that a change in BNSF's URCS costs could affect calculations of the jurisdictional threshold for some

movements. There is no doubt that it will have some effect on some jurisdictional threshold calculations, but, as we discuss next, the effect will be modest, and it is unlikely to have any significant impact on the rates BNSF is allowed to charge.

### C. The Practical Regulatory Impact Of The STB's Application Of GAAP Acquisition Cost Accounting To BNSF's Books Is Modest

WCTL's principal concern with the increase in BNSF's investment base appears to be that it will increase BNSF's URCS variable costs, which will raise the level of rates at the 180% jurisdictional threshold for some movements. WCTL suggests that this will result in significantly higher rates. WCTL Pet. at 2-4. Nothing could be further from the truth.

In the first place, it is BNSF's policy and practice to set its transportation rates on market demand, not the STB's variable cost determinations. GAAP purchase price adjustments to BNSF's asset base have no direct impact on the level of such transportation rates. Hund VS at 8-9. Second, only a relatively small portion of BNSF's rates are even regulated, so the potential impact of the acquisition premium is limited to a small subset of BNSF's rates.

Third, a write-up in the value of BNSF's asset base does not result in an equal percentage write-up in BNSF's URCS variable costs. On the contrary, many costs are not treated as variable by URCS, and for an average movement the increase in BNSF's asset values attributable to purchase accounting results in an increase in BNSF's system-wide variable costs of 5.6%. Baranowski/Fisher VS at 4. That is in the lower end of the range of the average increases in NS's and CSX's variable costs resulting from the Conrail transaction—respectively, 7.26% and 4.9%. 3 S.T.B. at 264. Those increases in variable costs, and in the jurisdictional threshold, did not alter the STB's view then that it should use the most economically correct data for making both jurisdictional threshold calculations and revenue adequacy determinations. By the same token, it should not alter the STB's view here.

WCTL in its petition attempts to distinguish the STB's *Conrail* decision by claiming that the Board has only determined that acquisition costs were properly included in the acquiring carrier's URCS costs in merger cases where the Board, in approving the mergers, found that they would produce cost reduction and synergies that would offset the increase in the railroad's URCS variable costs. WCTL Pet. at 6. That is not right. In 1989, the Blackstone Group, an asset management and financial services company, acquired and took private CNW Corporation, which owned the Chicago and North Western Transportation Company. *See Blackstone Capital Partners L.P.—Control Exemption—CNW Corporation and Chicago and North Western Transp. Co.*, 5 I.C.C.2d 1015 (1989). There was no discussion in the ICC's decision of the significant "acquisition premium" Blackstone paid or any merger synergies offsetting the acquisition cost. The lack of any merger synergies did not prevent the ICC from recognizing acquisition cost for its regulatory purposes. It bears emphasizing as well that, with the exception of *Conrail*, there has been no discussion in other merger and acquisition transactions involving "acquisition premiums" of merger synergies offsetting the acquisition cost.

In *Conrail*, the Board did observe, among other things, that the increases in URCS variable costs that would result from the acquisition cost would be offset over time by the merger synergies expected by the railroads. 3 S.T.B. at 263. But the STB also stressed, independently of any merger benefits, that its adoption and continued use of acquisition cost was driven by good economic policy. "[C]arriers cannot attract and retain capital unless they are given the opportunity to be compensated for the real value of the property, not just the book value." *Id.* at 265. Moreover, the STB found that the use of acquisition cost, as implemented by GAAP purchase accounting, was required both by its USOA, which followed the recommendation of the RAPB, and by Congress' mandate in Section 11161 that it use GAAP accounting to the

maximum extent practicable. *Id.* at 262, 264. Later, in the *Major Railroad Consolidation Procedures* rulemaking, the STB confirmed these economic and statutory reasons for using acquisition cost, and it made no reference to merger benefits. 2001 WL 648944, *18.

Further, even if a shipper were to challenge a BNSF rate in the future, the ultimate regulatory effect of the purchase price adjustment would be modest. Of BNSF's more than 9 million units moved in 2010, less than two percent represent regulated non-contract moves that, as a result of purchase accounting, could shift below the 180% jurisdictional threshold and not be subject to rate reasonableness challenge. Baranowski/Fisher VS at 5-6. Moreover, rates that fall close to the jurisdictional threshold are seldom the subject of shipper rate reasonableness complaints.

As to the effect on revenue adequacy, it is also modest. Revenue adequacy is calculated by applying the railroad industry's cost of capital, as determined annually by the STB, to the net investment base of each Class I railroad. *See, e.g.*, Ex Parte No. 558 (Sub.-No. 14), *Railroad Cost of Capital—2010* (served Oct. 3, 2011). Messrs. Baranowski and Fisher have performed calculations of BNSF's revenue adequacy for 2010 using the 2010 investment base reported by BNSF in its R-1 Annual Report under GAAP accounting. They have also performed an alternative calculation that removes the effects of the purchase accounting adjustments. Either way, BNSF is revenue inadequate. Baranowski/Fisher VS at 6.

As the STB pointed out in *Conrail*, neither the ICC nor the STB has ever decided a maximum rate case based upon whether the defendant railroad was or was not revenue adequate. 3 S.T.B. at 265.[15] In any event, insofar as revenue adequacy were ever to be applied as a

[15] Revenue adequacy does have an effect on one of the benchmarks used in the Three Benchmark test of rate reasonableness in small rate cases. The "RSAM" benchmark is intended to measure the average markup above variable cost that a railroad would need to charge to meet

regulatory constraint, as the STB concluded in *Conrail*, it must provide the opportunity for a railroad to be compensated for the real value of its property, not just the book value. *Id.* The use of acquisition cost comes much closer to accomplishing this goal than reliance on predecessor book values.

Out of the thousands of BNSF customers and hundreds of thousands of rates that BNSF maintains, the only customer that will be directly affected by the application of purchase accounting to BNSF's net assets is WFA/Basin. WFA/Basin's rate is the only current BNSF rate that the STB has prescribed as an R/VC ratio. In this instance, the increase in the size of the asset base as a result of the purchase price adjustment could ultimately result in an increase in the variable costs and, therefore, an increase in the prescribed rate. However, WFA/Basin's rate prescription is already the subject of a proceeding before the STB, and if the Board is concerned by the unique circumstances presented by the WFA/Basin prescription, the impacts of purchase accounting on that rate can be resolved there. That unique situation provides no grounds for altering the STB's general application of the acquisition principle to variable cost and revenue adequacy calculations.

### D. The Use Of GAAP Accounting For Mergers And Acquisitions Is Sanctioned By Congress

WCTL makes much in its petition of a letter from a group of Senators and Congressmen raising concerns about the application of GAAP accounting for regulatory purposes to Berkshire's acquisition of BNSF. WCTL Pet. at 4. WCTL's reliance on that letter is misplaced.

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its own revenue needs. It represents the revenue/variable cost ratio that the railroad needs to earn on "captive" traffic moving at an R/VC ratio above 180% in order to achieve revenue adequacy. Messrs. Baranowski and Fisher calculated the average RSAM for BNSF in 2010 with and without the effects of the purchase accounting adjustments, and then calculated the average ratio of the RSAM to the average R/VC greater than 180 for 2007 through 2010. They calculated that the average RSAM to R/VC greater than 180 is only 5.0% higher when the purchase accounting adjustments are included. Baranowski/Fisher VS at 7-9.

Individual Senators and Congressmen have constituents, to whom they understandably respond, but the STB's focus must be on Congress's official statutory mandates. As the Board pointed out in *Conrail*, Congress *by law* specifically "directs that [the Board] conduct [its] costing in accordance with GAAP to the maximum extent practicable." 3 S.T.B. at 264 (citing 49 U.S.C. § 11161). *See also* 49 U.S.C. § 11142 (requiring that the USOA be conformed to GAAP "to the maximum extent practicable"). Moreover, Congress earlier not only specifically directed that the ICC "prescrib[e] expense and revenue accounting and reporting requirements consistent with generally accepted accounting principles" but also directed that it "promulgate such rules pursuant to accounting principles established by the [RAPB]." *See AAR*, 978 F.2d at 741-42 (citing then Section 11166). That is exactly what the ICC did when it adopted acquisition cost as the measure of value for purchases of rail property based upon the specific recommendation of the RAPB. *See* RAPB Report at 45-48. Thus, the agency's consistent use of GAAP purchase accounting has always been attuned to Congress's official statutory requirements.

## Conclusion

The application of GAAP purchase accounting to railroad mergers and acquisitions has been endorsed by the RAPB, the ICC, and the STB, and it has been upheld twice by the courts. Congress has mandated the use of GAAP accounting to "the maximum extent practicable." WCTL and any other party that wishes the Board to abandon its uniform application of acquisition bears a very heavy burden, which they cannot carry. Nothing about Berkshire's

acquisition of BNSF distinguishes it in any material way from the many other transactions in which the Board has used purchase accounting. WCTL's petition should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Public version of the Opening Evidence and Argument of BNSF Railway Company were served on October 28, 2011 on all parties of record by first-class mail, postage prepaid, and on the following by hand delivery:

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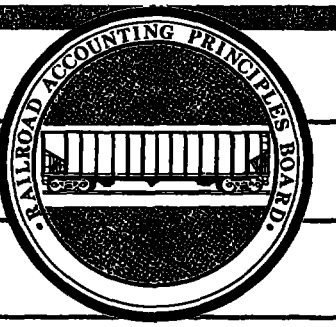
# EXCERPTS FROM

# RAPB FINAL REPORT

# RAILROAD ACCOUNTING PRINCIPLES

## FINAL REPORT

September 1, 1987
Volume 2—Detailed Report




RAILROAD ACCOUNTING PRINCIPLES BOARD

# CHAPTER 7

# Asset Valuation and Related Expense Principle

## STATEMENT OF PRINCIPLE

Assets shall be valued at either the value of the resources forgone by the entity to acquire the assets (GAAP cost) or at the current market value, depending on the regulatory applications. The method for valuing assets in each application shall be determined by the Causality Principle.

Where the GAAP cost reasonably cannot be viewed as a meaningful regulatory measure of value, other measures of value may be used.

## EXPLANATION

Valuation of assets is an integral part of determining the cost of railroad-related activities. It is used to determine movement costs, the results of operations, and ROI.

Asset valuation is an important element in virtually all regulatory applications because it forms the basis for measuring the monetary value of resources dedicated to and expended in railroad-related activities. An asset's valuation serves as a basis for calculating both the return of investment (in the form of depreciation expense) and the ROI (in the form of cost of capital). The calculations of each apply to specific movements as well as to the entity as a whole.

The RAPB has concluded that no single asset valuation method is appropriate for all regulatory applications; different time orientations of the specific regulatory applications require different valuation methods. Additionally, practical problems associated with certain valuation methods preclude their use in certain regulatory applications.

This Principle, therefore, represents a framework for selecting the appropriate valuation method on the basis of each specific regulatory application's time orientation. The Causality Principle identifies how time orientation influences the determination of the asset valuation method (see p. 10).

The RAPB considered five issues related to asset valuation:

- Time Orientation and Valuation Methods.
- Deferred Tax Credits and the Investment Base.
- Appropriate Historical Cost Method.

- Depreciation Accounting and the Restatement of Track Assets.
- Excess Assets and Write-Downs.

## TIME ORIENTATION AND VALUATION METHODS

### Alternatives

The RAPB considered several alternative methods for valuing assets, which are classified into two broad categories: historical cost and current market value. In the historical cost category, acquisition and predecessor costs were the two alternatives considered. In the current market value category, reproduction cost, replacement cost, and net liquidation value (NLV) were the alternatives considered.

#### Historical Cost

Historical cost measures asset value at the monetary value of resources sacrificed to acquire the assets. An asset's acquisition cost is amortized over its estimated useful life in railroad-related service. The net investment in an asset is the asset's value reduced by the cumulative amounts amortized. (Three methods for measuring historical cost are compared starting on p. 45.)

#### Current Market Value

Current market value may be measured by either the reproduction cost, replacement cost, or the NLV of existing assets.

***Reproduction Cost.*** Reproduction cost is the current market value for an identical asset in the same used condition. It represents the entrance value the firm would pay to purchase the assets in use today. Market values may be estimated by either the use of direct quotations (observation) or price indices of used assets.

***Replacement Cost.*** Replacement cost is the current market value of the best asset available to assume the functions of existing assets, thus replacing their existing service potential.[4] If replacement cost values are used, either the asset value or operating expenses must be adjusted to account for changes in operating advantage. Replacement cost may be estimated using either direct quotations or indices of new asset prices.

***Net Liquidation Value.*** NLV is the net realizable proceeds from an orderly disposition of assets. As an exit value, it represents the funds available for other investment opportunities. NLV may be estimated either by the use of direct observation or by independent appraisal.

### Analysis of Alternatives

As noted above, no single valuation methodology is appropriate for all regulatory applications. However, the arguments supporting each method are presented here. The selection of the appropriate valuation method is described in the specific regulatory application section of this chapter and in Part II of this volume.

The arguments regarding the alternative valuation methods fall into seven categories:

- Practicality.
- Verifiability and Objectivity.
- Opportunity Cost Measures.
- Compensation for Price Level Changes.
- Capital Requirements.
- Simulated Competitive Markets.
- Predictive Ability.

#### Practicality

For certain regulatory applications, such as Revenue Adequacy and GPCS, historical cost is more practical than current market value. Historical cost is prepared presently for financial reporting purposes and thus is readily available. The current market value methods require preparation or com-

[4]The RAPB's definition of replacement cost is similar to the FASB's definition of current cost in FAS No. 33. As defined by FASB, current cost includes an adjustment to asset value for differences in operating costs. The RAPB's definition would permit either adjustment of the cost of the asset or adjustment of the operating expenses themselves.

putation of additional information that is either (1) not feasible or (2) not cost effective to obtain for the entire entity.

For certain other regulatory applications, such as maximum rate proceedings, abandonment/surcharge proceedings, and minimum rate proceedings, current cost is more practical. Generally, preparing the additional analysis accurately for these applications is practical because only a portion of the firm's assets and operations are involved.

Descriptions of feasibility and cost effectiveness considerations follow.

***Feasibility.*** For revenue adequacy and GPCS applications, the use of current asset costs requires that the real cost of capital be used to prevent double recovery of price level changes. Maximum rate and competitive access proceedings do not require use of the real cost-of-capital rate to prevent double recovery because price level changes are explicitly included in the discounted cash flow (DCF) method as a separate item, the value of which is contestable. Minimum rate/Long-Cannon factor proceedings generally do not require the use of either the cost of capital or an asset value.

For a given level of risk without regard to inflation, the real cost-of-capital rate is the stable return that investors require. The real cost-of-capital rate is not observable in the financial markets because of the effects of inflation. It can only be estimated by removing investors' expectations regarding price level changes from the nominal (observed) rates.

Although numerous methods for estimating real cost of capital have been proposed, none appear to provide sufficiently reliable results (see Ch. 6, p. 36). Thus, the calculation of an accurate, stable, real cost of capital appears infeasible.

***Cost Effectiveness.*** The use of current asset value requires that certain adjustments be made in addition to depreciation expense. To perform these adjustments accurately requires significant time and expense; such an expenditure is not warranted for every regulatory application.

Use of replacement cost for asset valuation and reported operating expenses based on existing assets violates the Data Integrity and Causality Principles. These operating expenses do not represent the use of the replacement assets and, therefore, do not reflect a causal relationship. The assets used to establish replacement cost are the best assets available to perform the functions of existing assets. As the best available, they presumably include improved technology and efficiency. On the other hand, the reported operating expenses result from the use of less-productive assets.

Economic accuracy can be achieved by adjusting existing operating expenses to take into account the operating efficiencies of the replacement assets, by developing independent estimates of operating expenses associated with those assets, or by adjusting the asset value to consider the present value of any operating advantages. Except for certain specific or narrow applications, either approach is difficult to develop and troublesome to verify.

Reproduction cost adjusts existing asset values to match the current market value of identical assets. Market value may be established by either direct observation or through the use of indices which track changing values. However, on an entity-wide basis, direct observation is both costly and time-consuming.

Alternatively, use of indices is most often suggested as the more economical and efficient way of establishing market value. According to research, however, the use of indices has two practical problems. First, their application to the entire investment base or categories of assets assumes that all assets in the investment base are currently used and useful. To the extent that the investment base includes excess or underutilized assets, indices applied to the entire investment results in a proportionately greater overstatement of operating costs and investment base than occurs under acquisition cost.

Second, some have questioned the use of indices to estimate reproduction cost. Freeman and Willis (1984) note that the use of indices (as presently implemented) frequently measures the cost of new assets and, thus, may not properly represent the effects of technological change.

As with the other two current market value alternatives, use of NLV on an entity-wide basis appears to be impractical. The only accurate method for measuring NLV is to estimate the value of each asset. Preparing an estimate for the firm as a whole may be prohibitively costly. However, for applications that require an exit value for specific railroad

assets, these practical problems may be less significant.

### Verifiability and Objectivity

Historical cost is generally a more verifiable and objective method for measuring the cost of assets than current cost. Historical cost is determined through and supported by transactions. It is governed by GAAP, a well-defined set of principles.

The use of current market values generally is less verifiable, as its determination depends on the expert (but subjective) judgment of the preparer. The use of price-level indices to adjust historical costs to a market value may be one solution to the subjectivity concern. However, the use of indices may result in subjectivity problems associated with their construction or compilation and practical problems associated with the required adjustment of operating expenses. Additionally, it may be difficult to demonstrate the linkage between the items used in constructing the index and the specific assets of the firm that are to be adjusted.

### Opportunity Cost Measures

Certain regulatory applications, such as abandonment, surcharge, minimum rate, and the Long-Cannon factor, are decided on the basis of whether the activity at issue is reasonable in comparison to the best alternative activity. The best alternative activity has an opportunity cost associated with a decision not to pursue it.

The NLV represents the most accurate asset value for determining opportunity cost because it represents the purchaser's assessment of an asset's economic potential in alternative activity. The NLV is affected by demand for the asset. In certain circumstances, such as when the productive capacity of the assets is in great demand, the NLV may approximate replacement or reproduction cost. In other circumstances, such as when there is no longer a demand for an asset's productive capacity, the NLV may represent scrap value.

Usually historical cost is only coincidentally a valid estimator of NLV.

### Compensation for Price Level Changes

In many regulatory applications, the objective is to provide the enterprise with the opportunity to cover its operating expenses and cost of capital, and thus provide for prudent investment. To accomplish this objective, the firm must be able to cover, through its pricing decisions, the effects of price level changes (inflation or deflation).

Asset recovery may be accomplished by valuing assets and depreciation charges with either of two methods:

- Use current values in combination with a real (price level adjusted) cost of capital.
- Use historical values in combination with a current nominal cost of capital.

Using the current value of assets in combination with the real cost of capital is conceptually attractive because it provides for industry-specific price level changes. The degree of price level changes experienced may vary by industry. Moreover, including price level changes in assets specific to an industry implicitly incorporates the specific price level changes necessary to provide for reinvestment in assets.

Using the historical value of assets in combination with the nominal cost of capital provides for general price level changes. General price level changes are implicitly a portion of the current nominal cost-of-capital rate. Investors are compensated for general price level changes through the cost-of-capital rate.

### Capital Requirements

One argument favoring current asset valuation is that its use will provide capital adequate to replace the assets of the enterprise. This argument has two underlying assumptions: (1) that funds for reinvestment must be generated internally by the entity (no outside investment can be attracted) and (2) that essentially all assets will be replaced with funds provided from operations in advance of replacement.

The first assumption is not valid if investors can reasonably expect to earn a competitive return. In such cases, funds can be obtained from the capital markets.

The second assumption appears invalid in light of the recent significant railroad activity in writing down impaired assets (see Excess Assets and Write-Downs, p. 49). Had sufficient funds been provided from operations before the write-down, the rail-

roads would be left with a significant surplus of capital to be invested.

### Simulated Competitive Markets

An argument for using current market values is that it represents the pricing constraints of a competitive firm. A competitive firm establishes an upper limit on prices on the basis of the economic costs (including cost of capital) experienced by a new entrant. When that firm charges more than the new entrant's costs, new competitors enter the market. Prices will be driven to a point of equilibrium as the supply is increased.

Simulation of the competitive market forces often is used to identify prices for specific movements in relation to specific assets. It is not necessarily used for all regulatory applications, particularly where the objectives differ. In fact, it is precluded by certain practical considerations, as discussed above under Practicality.

### Predictive Ability

Certain regulatory applications permit an action to be taken that affects either the future provision of a service or the future price to be charged for a service.

Current asset value is argued to be a better predictor of the costs that will be incurred because it is more up to date. Therefore, it better matches future price (revenue) to future expenses.

To the extent that technology and inflation remain reasonably stable, historic cost measures also can serve as accurate predictors of future cost; current asset value does not provide better matching of future prices to future reported expenses automatically. The expenses reported in subsequent years' financial reports under GAAP will represent a combination of existing and new assets. The predictive accuracy of either the current cost or historical cost method is related to the timing and requirements for purchasing new assets. Also, technological changes associated with new assets require adjustment of operating expenses to accurately predict their total effect.

## DEFERRED TAXES

The RAPB concluded that the funds provided by deferred taxes have zero economic cost. The portion of the railroad's assets funded by deferred tax credits are provided by the government, not debt holders or investors. Since the government does not charge interest on the deferred tax "loan," the railroads incur no cost of capital associated for that portion of the investment base funded by deferred tax credits. The deferred taxes should, therefore, be deducted from the asset base.

By the end of 1984, deferred tax credits represented the source of funds used to "finance" 16.3 percent of the $58 billion of total Class I railroad assets. In the past, the ICC had treated deferred tax credits as having the same weighted average cost of capital as funds provided by debt and equity. In its December 31, 1986, decision in Ex Parte No. 393 (Sub-No. 1), *Standards for Railroad Revenue Adequacy*, the ICC reversed its position and, for future revenue adequacy determinations, elected to treat deferred tax credits as having a zero cost of capital by subtracting the deferred tax credits from the investment base.

In resolving the treatment of deferred taxes, the RAPB considered three questions:

- Should deferred taxes be recognized?
- If so, what cost should be accorded deferred taxes?
- Which method for treating deferred taxes should be used?

### Recognition of Deferred Taxes

Two methods of accounting for deferred taxes have been proposed to the RAPB: (1) the comprehensive inter-period tax allocation method as required by GAAP and (2) the flowthrough method. The comprehensive inter-period tax allocation method recognizes deferred taxes but may be applied in several different ways. The flowthrough method ignores deferred taxes entirely but includes inter-period allocation of other expenses (such as depreciation); only actual taxes paid by the railroad are reflected in income.

Advocates of the comprehensive inter-period tax allocation method cite the treatment of accumulated depreciation to explain their support for the recognition of deferred tax expense. Taxes are based on the income generated by assets over their useful life. Thus, recognition of deferred taxes attributable to individual assets is appropriate.

The contingencies applicable to deferred taxes are no different than those in other areas of accounting. To support this contention, the advocates cite the "going concern" concept used in GAAP and the expected continuation of the present tax system.

Those supporting recognition of deferred taxes find support in the fact that individual transactions are planned in light of their tax consequence. They claim that requiring the benefits of accelerated depreciation to be passed on to customers (as in flowthrough) would circumvent the intent of the Congress in providing accelerated depreciation. Finally, those supporting recognition of deferred taxes cite its compliance with GAAP.

Some advocates of flowthrough point out that income taxes result from taxable income, not book income. Linking income tax expense to pretax accounting income results from a misperception of the economic nature of income taxes. Further, deferred tax liabilities are really contingent on future income and future tax regulation.

The RAPB is persuaded by arguments in favor of the comprehensive inter-period tax allocation method for recording deferred taxes. It reached this conclusion on the basis of (1) the role that tax considerations play in investment decisions, (2) congressional intent to stimulate investment, and (3) conformance with GAAP.

On September 2, 1986, the FASB issued a *Proposed Statement of Financial Accounting Standards*, "Accounting for Income Taxes." The Proposed Statement would retain the requirement for comprehensive inter-period tax allocation. The Proposed Statement, however, would measure the effects of income taxes by the liability method, in place of the deferred method currently required by the Accounting Principles Board (APB) *Opinion No. 11*, "Accounting for Income Taxes." In most cases, cumulative income statement items will not correspond to balance sheet amounts, as would have resulted under APB *Opinion No. 11*, even though they might be the same in a particular year. An important difference for regulatory purposes is that the liability method would require immediate adjustment of the deferred tax liability to reflect the effect of a change in tax laws or rates.[5] The Proposed Statement would be effective for fiscal years beginning on or after December 15, 1987. It permits companies to either restate previously issued financial statements or include the cumulative effect of applying the Statement in net income of the year of initial application.

The magnitude of the proposed change will be greatly increased by the change, effective July 1987, in the federal corporate income tax rate from 46 percent to 34 percent. That change affects deferred tax credits that have been accumulated at a 46-, 48-, or other percent rate, but which will be liquidated at a 34-percent rate.

The RAPB generally intends for deferred taxes to be computed in accordance with GAAP, including changes thereto. Consequently, the RAPB expects that deferred taxes will be computed for regulatory purposes under the Proposed Statement when it becomes effective. The RAPB has not, however, considered how the cumulative effect of applying the Proposed Statement should be treated for regulatory purposes. The alternative methods proposed by the FASB may or may not be appropriate for regulatory purposes; that issue is left to the ICC.

## Cost of Deferred Taxes

Three alternatives for recognizing deferred taxes were proposed to the RAPB: the utility method, the finance method, and the "weighted average debt and equity" method. The utility and finance methods (along with an additional DCF method discussed below) value deferred taxes as an interest-free source of capital. The weighted average debt and equity method implicitly values accumulated deferred taxes at the weighted average cost of debt and equity.

Advocates of the utility or finance methods raise three primary arguments. First, the Congress intended to stimulate investment by permitting accelerated depreciation to be used for tax purposes even though other methods are used for financial reporting. The resulting deferral of tax payments to the government provides funds for investment, consistent with the Congress' intent. Second, deferring payments without interest rep-

[5]Under the deferred method, immediate adjustments to the deferred tax account are not made in response to changes in the tax law or rates. Such changes are recognized when timing differences reverse.

resents an interest-free loan from the government. Although such a loan has a cost to the government, it has no cost to the railroad entity. Third, new and existing competitors would have similar interest-free funds available. In a competitive market, competition would force the firm to pass on the reduced cost of capital to customers.

Advocates of the weighted average debt and equity method raise two primary arguments. First, the Congress' intent to stimulate investment will not be met, since firms will not invest if they are not permitted to earn a return on the funds provided by deferred taxes. Second, investors in competitive markets expect to earn a return on all assets.

The RAPB concluded that cumulative deferred tax credits should be treated as a zero cost of capital. In a competitive market, the firm would not be forced by regulators to pass on to its customers the benefits of zero-interest financing. However, a firm may be compelled by competitive circumstances to pass the benefits on to its customers.

### Methods for Treating Deferred Taxes at Zero Cost

The two alternatives which recognize deferred taxes as an interest-free source of funds are the finance method and the utility method.

Under the finance method, the development of an industry-wide cost-of-capital rate is adjusted to recognize cumulative deferred tax credits as a zero cost component. This method would violate the Causality Principle because railroads differ materially in the extent to which they are able to finance investments through the use of deferred tax credits.

Under the utility method, deferred tax credits reduce the eligible investment base by the cumulative deferred tax credits. The RAPB concluded that reducing the historic investment base by applicable deferred tax credits is the most practical approach for revenue adequacy and GPCS applications.

An additional alternative, the DCF method, is used for multiyear analyses. Because it does not use the accounting reporting convention of inter-period allocation, neither asset consumption nor taxes are allocated. Use of the DCF method is consistent with the utility method since tax consequences of asset expenditures reduce the net investment in the analysis. When a DCF is used for stand-alone cost, deferred tax credits are always zero, since this method only includes the taxes actually paid during the life of the investment.

One party urged the RAPB to adopt the finance method for abandonment/surcharge applications. It reasoned that the Causality Principle requires that opportunity costs in abandonment/surcharge cases reflect the treatment of deferred taxes at zero cost. Since the ICC applies a pretax cost-of-capital rate to NLV to determine abandonment/surcharge opportunity costs, the cost-of-capital rate should be adjusted using the finance method so that deferred taxes may be reflected at zero cost.

The RAPB rejects this suggestion. Contrary to the commenting party's assertion, the Causality Principle would preclude use of the finance method in specific applications where no causal link exists between deferred taxes of the entire entity and deferred taxes related to specific branch-line assets. The RAPB believes that proper treatment of deferred taxes, consistent with the Causality Principle, is to recognize the tax consequences associated with specific branch-line assets. This treatment may be accomplished by adjusting NLV to reflect the tax consequences of a gain or loss on disposal of the branch-line assets.

## APPROPRIATE HISTORICAL COST METHOD

The RAPB concludes that use of GAAP cost for business combinations represents the superior method for measuring economically accurate costs when using an historical cost method. If a business combination qualifies as a "pooling of interests," it is accounted for as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interests continue and the former bases of accounting are retained. The recorded assets and liabilities are carried forward to the combined corporation at their previously recorded amounts.

A business combination generally is treated as a "purchase," accounted for as the acquisition of one company by another. The acquiring corporation records the fair-market value of the acquired assets less liabilities assumed as its cost. It records the excess (if any) of the cost of an acquired company

over the sum of the fair values of tangible and identifiable intangible assets less liabilities as goodwill.

The ICC may determine through rulemaking that the use of GAAP cost does not produce meaningful regulatory results in certain situations. For example, if either a depressed or overvalued market value primarily results from government action [6] or regulatory policy, the entity may use another measure, such as predecessor cost or a modification.

## Alternatives

The RAPB considered which of three alternative measures of historical cost should be used: acquisition cost, GAAP cost, or predecessor cost.

The RAPB defined acquisition cost as the lower of (1) the aggregate purchase price of the firm or (2) the fair value of the tangible and identifiable intangible assets at the time of the business combination. Any excess of aggregate price of the firm over fair value of the assets would be considered goodwill and not included in the net investment base. Nor could it be amortized against net operating income.

GAAP uses acquisition costs (as defined above) in connection with purchases and reorganizations. In a "pooling of interests," GAAP continues the net book value of the pooling entities. In the RAPB's opinion, the use of GAAP cost is a practical alternative to acquisition cost, as firms presently maintain accounting records on this basis for financial statement presentation. In the analysis below, the theoretical arguments favoring acquisition cost also apply to GAAP cost (except for business combinations treated as a pooling by GAAP).

Predecessor cost represents the cost to the person first devoting the property to public service.

## Analysis of Alternatives

The RAPB considered the following arguments in selecting GAAP cost:

- Economic Accuracy.
- Capital Attraction.
- Replacement Cost Approximation.
- Comparable Treatment.
- Windfall Earnings.
- Practicality and Verifiability.

### Economic Accuracy

The use of acquisition (or GAAP) cost better represents the economic conditions facing the enterprise than does predecessor cost because a large share of the industry's revenues are determined by competitive markets rather than through the regulatory process. A substantial portion of the railroads' traffic is no longer subject to ICC maximum rate regulation because it falls below the jurisdictional threshold, is exempt, or moves under contract. By implication, when most rates are set by competition, the market values of assets are based primarily on competitive economic conditions and not on the regulatory process.

The use of predecessor cost has been adopted by most public utility commissions to preclude upward or downward manipulation of asset values. However, predecessor cost is appropriate only if market value is established predominantly through regulatory policy. Market value is determined by regulatory policy when the regulated enterprise has sufficient market power such that a material portion of its rates is influenced by what the regulators allow. Alternatively, the market value of the regulated enterprise could be driven to depressed levels by improper regulation.

However, supporters of predecessor cost point out that it would be illogical (circular) to set rates based on acquisition cost because by so doing rates would be dependent on a value which in turn is based on rates. For this to be true, GAAP cost would have to be used directly in ratemaking and the regulated enterprise must possess sufficient market power that rates are materially affected by what the regulator allows. Considering the large share of the railroad industry's revenues determined by the

[6] The restrictive covenants associated with the federal government's sale of its Conrail stock is an example of government action affecting sales price. Section 4012(e)(2) of the Conrail Privatization Act (P.L. 99-509, Title IV (1986)) appears to preclude the use of the sale price of Conrail stock for regulatory purposes.

competitive markets, the RAPB believes that concerns about circularity are probably unfounded at this time.

Also, supporters of predecessor cost state that a lower acquisition value occurs primarily due to the impact of all regulation (including revenue adequacy, maximum rates, car hire, merger, etc.) and not primarily because of excess assets. To address these concerns, the Asset Valuation and Related Expense Principle provides that other measures of value may be used where GAAP cost reasonably cannot be viewed as a meaningful regulatory measure of value.

### Capital Attraction

A primary objective of the SRA is to assist railroads in attaining revenue adequacy. To accomplish this objective, investors must be permitted to earn a market return on their investment. As long as investors can earn a rate of return comparable to other market rates of return for investments of comparable risk, they will continue to invest.

Use of GAAP cost is consistent with the objective of enabling railroad entities to attract capital for the replacement of necessary assets. Railroad assets will be replaced so long as competitive returns are allowed on the existing and new investments of the entity. The use of predecessor cost, when higher than acquisition cost, assumes that funds for replacement must be generated in advance of the reinvestment. However, if investors reasonably can expect to earn a competitive return, capital can be attracted when it is required and the accumulation of funds in advance of the reinvestment is not necessary.

### Replacement Cost Approximation

Some argue that predecessor cost is closer to replacement cost because (1) replacement costs for the railroads are greater than either predecessor or acquisition costs and (2) predecessor costs are greater than acquisition costs as experienced by the affected railroads. This assertion is not universally true, as may be observed in many other industries where predecessor cost easily may be lower than GAAP cost.

Some have argued that any change in an original cost asset base will produce results which differ from the replacement cost investment models. Static investment models may be used to demonstrate that a replacement cost investment base used in conjunction with the real cost-of-capital rate can produce results identical to those achieved using an original (predecessor) cost investment base in conjunction with a nominal cost-of-capital rate. However, this argument does not recognize that certain events take place which require recognition in any regulatory asset base measurement.

Two examples of changes that must be recognized are (1) permanently underutilized or earnings-impaired assets that should be valued at the higher of NLV or the present value of the net cash flows those assets can generate in their present use and (2) excess or redundant assets that should be eliminated from the investment base.

In purchase transactions, GAAP cost implicitly values permanently underutilized or earnings-impaired and excess or redundant assets at the higher of NLV or the present value of the net cash flows those assets can generate in their present use. That valuation results because the market price is an efficient measure of the underlying economic value. That valuation is appropriate for underutilized or earnings-impaired assets. When the valuation is less than predecessor cost, the effects of improperly including excess assets in the asset base is minimized.

### Comparable Treatment

In considering alternative approaches to asset valuation, comparable assets should be accorded comparable treatment if such treatment is practical. Under acquisition costs, all assets acquired or combined are valued at their fair market value. Thus, regardless of the accounting method, the recorded values of assets are comparable. GAAP cost, on the other hand, considers assets that are acquired in a purchase and those combined in a pooling to represent essentially different transactions. Thus, the assets are not given comparable treatment. However, the RAPB believes that practicality considerations are of greater importance than comparability and that the circumstances associated with pooling are sufficiently different to warrant different accounting treatment.

Similarly, permanently impaired assets should be accorded comparable treatment whether the asset is written down involuntarily (through sale or reorganization) or voluntarily. When an involuntary

write-down of excess assets occurs as part of a purchase or reorganization, the use of predecessor cost effectively nullifies the effect of the write-down unless the assets are voluntarily written down at a later date. However, in such a case, the railroad has had the benefit of an inflated investment base until the voluntary write-down is taken. On the other hand, when a voluntary write-down of assets is made by a railroad's management to recognize excess assets, the reduced net asset valuation is used and the associated losses may be recognized in earnings for revenue adequacy purposes. Thus, if the ICC determines that GAAP cost is not appropriate for a particular regulatory application, the ICC, to achieve comparability, may find it necessary to remove estimated excess assets from predecessor cost.

### Windfall Earnings

Permitting competitive returns on an investment greater than that actually made by the successor entity provides that entity the opportunity to earn a return greater than the cost of capital. While this "windfall" is not guaranteed, it represents an opportunity which is not available to investors in competitive enterprises (the requirement for regulation rests on the presumption of certain monopoly powers that must be held in check). On the other hand, under GAAP purchase accounting, an investor paying more than book value for a successful railroad enterprise may be allowed to charge higher rates on captive shipments than under predecessor cost.

### Practicality and Verifiability

While not considered explicitly as an argument in the Exposure Draft, the Practicality and Data Integrity Principles directly affect the selection of an historical cost method. Many commenters were concerned about practicality and verifiability in using acquisition cost in a pooling. In light of these concerns, the RAPB decided to address the practicality and verifiability of the three alternatives explicitly.

Some commenters stated that applying acquisition cost to assets acquired in a pooling is too subjective, as it relies extensively on judgment. They noted that the absence of a purchase transaction means there are no records supporting the transaction price. Furthermore, reliance on market valuation at the time of the pooling causes the valuation to fluctuate widely because of the volatility of the equity markets.

Commenters also raised concerns about the merits of applying a market valuation to both parties in a pooling. They stated that such application results in different measurements than those resulting from a purchase in which only the purchased party is revalued.

GAAP represents the most practical and verifiable historical cost method because the records used to support it are the same as those currently maintained by the railroads in support of financial accounting. By permitting the use of pooling, the RAPB avoids the practical problems associated with acquisition cost.

Predecessor cost requires the maintenance of separate predecessor cost records. These records are currently maintained and updated by the ICC on the basis of annual submissions by the railroads.

## DEPRECIATION ACCOUNTING AND THE RESTATEMENT OF TRACK ASSETS

To develop economically accurate costs, virtually all parties endorsed the use of annual expenses, prepared in accordance with GAAP. Many recognized the need to adjust the GAAP-generated capital costs. The three elements of capital costs are (1) valuation of the capital asset base, (2) the method of recognizing annual expense for the consumption of assets (return of investment), and (3) the annual capital charge to be recovered (ROI).

The ICC has introduced the use of depreciation accounting (DA) in stages. Since 1983, the railroads have used DA in their R-1 reports to the ICC. Before 1983, railroads used the replacement-retirement-betterment (RRB) method of accounting for track structures. Until 1986, the ICC retained use of the RRB method for revenue adequacy and GPCS by requiring the railroads to furnish supplemental RRB data. In its December 31, 1986, decision in Ex Parte No. 393 (Sub-No. 1), *Standards for Railroad Revenue Adequacy*, the ICC abandoned the use of RRB for revenue adequacy determinations.

Under the RRB method, the acquisition cost of the initial investment is recorded on the books as a nondepreciable asset. No depreciation expense is taken over its estimated useful life. When it is replaced with an asset of similar quality, the entire cost of the replacement is charged to operating

expense. Only the incremental betterment portion of the new asset is added to the books. When the asset is retired, the acquisition cost (original investment), including any betterments, are charged to expense.

In evaluating RRB, the RAPB noted problems or shortcomings which impaired the attractiveness of RRB:

- Under current ICC procedures, a railroad must maintain and report on two separate sets of books for track assets.
- The continued use of RRB for revenue adequacy or any other purpose is no longer in conformance with GAAP.
- While more sensitive to inflation than DA, RRB does not accurately measure the cost of assets consumed in providing service or the asset base devoted to railroad service.

Under the DA method, many of these shortcomings either are not applicable or can be overcome:

- Since railroads converted to DA for financial accounting and R-1 reporting purposes, DA's use in revenue adequacy determinations alleviates the need for the second set of books to support RRB.
- DA is consistent with GAAP.
- While not directly sensitive to inflation, use of DA reduces many of the concerns about inflation when used with a nominal cost-of-capital rate.

As a result of DA restatement procedures and the industry's pattern of track replacement, the differences between ROI measured using RRB and DA are not significant. Thus, the RAPB concluded that DA is more economically accurate.

The RAPB considered a second issue regarding whether the restatement of track asset values resulting from the conversion to DA is appropriate for regulatory purposes. Essentially, a restatement requires railroads to treat existing track assets, which were previously expensed under RRB, as if they had been capitalized and depreciated. The procedure resulted in a substantial net increase in depreciable assets, deferred tax credits, and retained earnings. The restatement is a material amount, with approximately $7 billion added to the asset base.

The RAPB has reached several conclusions in its analysis of the restatement:

- The restatement will result in certain track asset costs being charged a second time to operating expense over the remaining life of the assets.
- Charging these expenses twice does not necessarily indicate that the railroads will receive double recovery or payment from customers.
- The restated asset base and future operating expenses are the same as if railroads had always been using DA for track structures.

While the RAPB concludes that use of DA with its restatement of track assets is more economically accurate, certain parties have questioned the fairness of permitting the railroads two opportunities to recover the $7 billion of track assets resulting from the restatement. A determination of the appropriateness of this approach or an alternative for regulatory purposes rests with the ICC which should review the matter (including public participation by all interested parties).

## EXCESS ASSETS AND WRITE-DOWNS

Since excess assets in the investment base may cause inaccuracies in the ROI and depreciation expense calculations, all commenters agree that those assets should be identified and eliminated from the asset base. They identified two different approaches for consideration: (1) reliance on existing professional accounting practices and Securities and Exchange Commission (SEC) guidance and (2) regulatory study and investigation of the asset base. The RAPB believes the first approach is adequate.

W.A. Paton and A.C. Littleton, in their *Introduction to Corporate Accounting Standards* (1970), point out:

> "If . . . it has become apparent that the effective service life of a[n] [asset] . . . has been seriously curtailed by the unexpected obsolescence or other special factor, and the accrual of depreciation to date is inadequate, the recognition of the additional cost expiration need not and should not await actual retirement. To postpone a special write-down in this situation would mean the avoiding of the recognition of a loss

already suffered and would be likely to lead to a padding of the operating charges (or losses) of the future."

Thus, assets should be written down when their earning capacity is permanently impaired or when they cease to have economic usefulness. The write-downs are treated as a loss and should be clearly reported as such in the income statement. The write-down of impaired assets is consistent with SEC requirements. If the sum of the undiscounted future cash flows will be less than the net book value of an asset, a write-down is recommended by general accounting practice.

Similarly, the traditional regulatory model recognizes that assets may become impaired and, therefore, requires that the net investment base be continually reviewed to purge from the investment base assets that are not used or useful. However, in contrast to professional accounting practice, this model requires scrutiny of write-downs to determine whether and in what manner their recovery should be allowed.

Both approaches rely on a certain degree of subjective judgment. The regulatory investigations are believed to be more impartial as the investigator has no direct financial interest. However, impartiality may not result in any material improvement in accuracy. The low expectation of improved accuracy, combined with the materially higher cost of regulatory investigation, favors continued reliance on professional accounting practices and SEC guidance.

Examples of voluntary write-downs in the railroad industry were numerous in 1986 as five large railroads wrote down nearly $2 billion in assets. Before these write-downs, the railroad industry had maintained that no material excess capacity existed. To the extent that material excess capacity still exists, the industry should identify and eliminate it from the investment base.

The RAPB has concluded that the write-down of excess railroad-related assets against operating income is appropriate if professional accounting practices are rigorously followed. However, the RAPB has recognized in its determination of other asset valuation issues that some of the alternative non-GAAP valuation methods (such as predecessor cost) may be seriously affected by excess assets. Moreover, small improvements in accuracy may be material. Future adoption of any of these alternative methods would require, therefore, additional analysis of the treatment of excess assets.

## APPLICATIONS AFFECTED

The Asset Valuation and Related Expense Principle affects all of the specific regulatory applications addressed by the RAPB.

# CHAPTER 9

# Revenue Adequacy

## EXPLANATION

The ICA requires the ICC to determine annually which railroads subject to its jurisdiction are earning adequate revenues. It states that adequate revenue levels should provide for the recovery of expenses and the attraction and retention of necessary capital for continued operations.[7]

The ICC has determined that a railroad has adequate revenues when its ROI equals or exceeds the cost-of-capital rate.[8] Thus, the RAPB's focus on revenue adequacy is limited to the economically accurate determination of railroad ROI and the cost-of-capital rate.

The RAPB has not considered the economic accuracy of alternative revenue adequacy standards not presently used by the ICC (such as funds flow, ratio analysis, and return on equity). However, should the ICC adopt a different revenue adequacy policy in the future, the RAPB intends that its Principles be applied to the extent they are relevant. For example, if the ICC selected return on equity as the revenue adequacy standard, the Entity and Asset Valuation and Related Expense Principles would apply in their entirety, and the Cost of Capital Principle would apply in part.

## APPLICATION OF PRINCIPLES TO REVENUE ADEQUACY

Principles which apply to revenue adequacy determinations are:

- Causality,
- Practicality,
- Data Integrity,
- Entity,
- Asset Valuation and Related Expense, and
- Cost of Capital.

### Causality

The time orientation concept in the Causality Principle is pertinent to revenue adequacy determinations. Because ROI for a period is used as a measure of the ability to attract capital in a competitive market place, it must be compared with the cost of capital in that market place for the same time period.

[7] 49 U.S.C. 10704(a)(2).

[8] Ex Parte No. 393, *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981), aff'd *Bessemer & Lake Erie R.R. Co. v. I.C.C.*, 691 F. 2d 1104 (3rd Cir. 1982), *cert. denied*, 462 U.S. 1110 (1983). In a subsequent proceeding, docketed as Ex Parte No. 393 (Sub-No. 1) (served Dec. 31, 1986), the ICC reviewed the ROI standard, among other revenue adequacy-related matters, and reaffirmed its use as the single standard for determining revenue adequacy.

## Practicality

According to the Practicality Principle, ROI information may be submitted in condensed supplemental schedules rather than in full consolidated/combined reports. Accurate ROI computations for revenue adequacy purposes do not require the level of detail contained in annual reports to the shareholders, the SEC, and the ICC. However, ROI information should reconcile with annual report information in the sense that amounts can be traced.

## Data Integrity

According to the Data Integrity Principle, the data used to develop individual railroad ROI and the industry cost-of-capital rate require different approaches, described below, for assuring data integrity because they are obtained from different sources.

Each railroad entity's revenue, expense, and investment data are used to compute its ROI. These data are reported in the R-1 or, under the Entity Principle, in a condensed supplemental consolidated/combined schedule filed annually.[9] Since critical items of these reports are periodically audited using agreed-upon procedures by independent public accountants, these data may satisfy the Data Integrity Principle for revenue adequacy purposes by relying on established standards.

Unlike ROI data, which are filed with the R-1, information used to determine the industry cost-of-capital rate is submitted in an annual Ex Parte proceeding. This information is based on samples and estimates of market debt and equity costs. Data integrity for cost-of-capital rate determinations may be accomplished through established ICC procedural rules regarding the presentation and support of evidence.

## Entity

The Entity Principle defines the portion of potentially complex conglomerate organizations which represent railroad-related business enterprises. The railroad entity provides the boundaries for measuring revenue, expense, and the asset base for ROI computations.

For revenue adequacy purposes, the ROI calculation is based on the railroad-related activities of affiliated railroads and their railroad-related affiliates. This entity represents the business enterprise undertaking railroad-related activities rather than a legal entity.

The Entity Principle describes which activities are considered railroad-related and how affiliation is determined. Railroad-related activities are those which support railroad operations. Affiliation is determined in accordance with GAAP.

Accurate railroad-related ROI measurements should include only the assets used in railroad-related activities and the revenues and expenses resulting from their use. Conversely, ROI measurements should exclude nonrailroad-related assets, liabilities, revenues, and expenses. However, according to the Practicality Principle, ROI measurements either may include or exclude all of an affiliate's assets, revenues, and expenses depending on whether (1) segregation is impractical and (2) the affiliate is predominantly railroad-related. An affiliate is predominantly railroad-related if it could not exist but for the revenue derived from or the support provided for railroad operations.

Because practicality considerations may result in the exclusion of entire railroad-related affiliates, railroad-related transactions between the railroad entity and affiliated companies outside the entity may occur. To include the economic effect of such transactions between the railroad entity and affiliated companies outside the entity, the transactions should be stated at fair market value in computing ROI. Railroad-related transactions with companies outside the railroad entity may produce gains or losses which should be included in ROI computations.

## Asset Valuation and Related Expense

Once the boundaries of the railroad entity are determined, the entity's assets must be valued to produce

[9]Even though the Entity Principle requires consolidated or combined reporting of activities of affiliated railroads and their railroad-related affiliates, the current R-1 does not report data in this manner for some railroad entities. The Practicality Principle states that information required for revenue adequacy may be reported in condensed supplemental schedules rather than in full consolidated financial reports.

the denominator for ROI. The Asset Valuation and Related Expense Principle, as applied to revenue adequacy, provides for asset valuation in accordance with GAAP. However, if the ICC determines that acquisition cost is not a meaningful measure of value in a particular case, other measures of value may be used, including predecessor cost.

According to the Asset Valuation and Related Expense Principle, the entity's deferred tax credit balance must be subtracted from its investment base. Unlike debt and equity sources of funds, deferred tax credits are a zero cost source of funds. Since the purpose of a revenue adequacy determination is to ascertain whether a railroad entity is earning revenues sufficient to attract and retain capital, that portion of the investment base which is financed through deferred taxes should not be included in the ROI.

The "return" comprising the ROI numerator is also affected by the Asset Valuation and Related Expense Principle. The return computation incorporates, among other expenses, the annual depreciation expense associated with the asset base.

### Cost of Capital

As mentioned previously, the industry-wide cost-of-capital rate is the standard against which ROI generally is compared to determine revenue adequacy. As such, it represents the return required to attract and retain capital necessary for the provision of a sound rail transportation system in the United States.

The Cost of Capital Principle describes the components and the method by which they are combined to produce a weighted average rate expressed as a percentage. The cost-of-capital rate is a nominal rate comprised of market debt and equity costs weighted by their proportions of the railroad industry's market-valued capitalization. The debt and equity capitalization portions are determined for a single year.[10]

## ANALYSIS SUPPORTING/REJECTING CHANGES TO THE APPLICATION

Alternatives affecting revenue adequacy determinations were considered by the RAPB in developing the Entity, Asset Valuation and Related Expense, and Cost of Capital Principles.

### Entity

Of four alternative entity definitions for revenue adequacy, the RAPB selected the broadest: combined railroad-related activity. Chapter 5, "Entity," contains a detailed discussion of the entity alternatives; that discussion will not be repeated here. However, to summarize briefly the reasons for the selection, the RAPB concluded that the combined railroad-related entity was superior to the other narrower alternatives for the following reasons:

- It represents the economic entity performing railroad-related activities rather than a management or legal structure. The RAPB entity is compatible with the measurement of performance of railroad activities and is consistent with the economic entity concept in financial accounting (given the limited regulatory scope).

- It reduces the potential effect of manipulation through transfer of economic wealth within the family of interests which includes the regulated entity. In consolidating/combining railroad-related affiliates, the economic effect of transfers between these companies are eliminated. Thus, the significance of asset transfers and of transfer pricing of materials and services is reduced.

- It results in more cost effective report preparation than the ICC R-1 entity or the operating entity. Although the entity adopted by the RAPB may result in slightly higher reporting costs than the alternative consolidated entity, the entity adopted by the RAPB produces greater economic accuracy for railroad regulatory application. Moreover, these additional reporting costs may be reduced by submitting condensed supplemental schedules and by including or excluding entire railroad-related affiliates when separating the railroad-related activities is impractical.

- It enhances the ability to rely on internal controls and audit coverage required for external financial reporting. The affiliates to be consolidated are already subject to external audit and, therefore, may be more easily reconciled with the existing financial reports.

[10]Ch. 6 contains an in-depth discussion of the derivation of the components and the construction of the weighted cost-of-capital rate.

- For some railroads, it more closely resembles the entity which enters capital markets than narrower entity alternatives. Since measuring the ability to attract and retain capital in competitive capital markets as a result of railroad operations is the objective of revenue adequacy determinations, the entity should be defined to measure the performance affecting this ability. The resulting railroad entity enhances comparability between the railroad industry and other industries.

## Asset Valuation and Related Expense

Asset valuation cannot be isolated from cost-of-capital rate determination. A current-cost asset base requires either the use of a real cost-of-capital rate or the recognition of capital gains or losses for the period of time in which assets are held. Conversely, a historical-cost asset base requires the use of a nominal cost-of-capital rate to account for inflation in capital costs. Since both the asset valuation and the cost-of-capital rate include the impact of inflation, a nominal cost-of-capital rate used in conjunction with a current-cost asset base would result in a double count of inflation in capital costs.

The RAPB considered current market value[11] and historical cost[12] as the basis for asset valuation. It selected historical cost net of accumulated depreciation.

The argument for current market value valuation is that this methodology is consistent with economic principles which value assets in terms of opportunity cost. In most cases, opportunity cost is measured by the replacement cost of assets with similar remaining productive lives and capacity.

An argument for historical cost valuation is that it is used by the financial community to evaluate financial viability of all industries competing for capital in the market place. Since measurement of the ability to attract and retain capital in competitive capital markets is the purpose of revenue adequacy determinations, historical valuation is appropriate.

Another argument for historical cost valuation is that such costs are more verifiable than current market value estimates. Proponents of historical valuation state that severe practical problems are encountered in accurately estimating the current market value of the asset base and in estimating the real cost-of-capital rate.

The RAPB believes that current market valuation is preferable to historical valuation from a theoretical economic viewpoint. In revenue adequacy applications, current market value represents the value upon which competitive returns must be earned to attract and retain capital. Moreover, directly accounting for capital cost inflation in asset valuation reduces potentially significant variations between asset-specific inflation rates and economy-wide inflation rates encompassed in nominal cost-of-capital rates used in conjunction with historical asset valuation.

However, the RAPB believes that serious practical problems are encountered in applying current market valuation for revenue adequacy determinations:

- Unlike most other regulatory applications, revenue adequacy determinations require valuation of the asset base for the entire railroad entity.[13]
- While historical asset valuation may be determined directly from the entity's regularly maintained accounting records, current market valuation requires identification of the value of the remaining productive capacity of an entity's assets. This information is not regularly maintained in the entity's accounting records.
- The revaluation task is complicated by the need to identify and revalue existing assets which will not be replaced. In addition, other assets will not be replaced in kind. Rather, they will incorporate technological changes.
- Depreciation expense associated with current valuation must be derived to reflect the composition and life expectancy of a current cost asset base.

[11]Actually, three current approaches were considered: Reproduction Cost, Replacement Cost, and NLV. Ch. 7 contains a description of each of these approaches.

[12]The term "historical" asset valuation, as used here, corresponds to GAAP valuation. Alternative historical cost methods considered were acquisition and predecessor cost (see Ch. 7, p. 39).

[13]Most other regulatory applications, such as maximum rate costs, competitive access costs, and branch-line abandonment costs, pertain to specifically identified portions of the railroad entity, not the entire railroad entity. Thus, practical measurement problems are not as severe.

- A reliable real cost-of-capital rate, required in conjunction with a current cost asset base, is difficult to compute accurately. This problem is addressed further in the following section.

### Cost of Capital

The RAPB considered numerous issues pertaining to cost-of-capital rate determination. Since the alternatives considered for each issue and the reasons for accepting or rejecting them are presented in Chapter 6, the RAPB focuses here on the alternative measurement methodologies that significantly influenced its selection.

Of the three alternative cost-of-capital rate measurement methodologies considered—traditional, current nominal, and real—the RAPB selected the current nominal cost-of-capital rate for four reasons:

- A substantial portion of the railroad industry's traffic base is no longer subject to ICC regulation. As a result, a large share of the industry's revenues are determined by competitive markets rather than through the regulatory process. Under the traditional approach, if current market debt rates exceed embedded debt rates, regulatory lag may preclude subsequent recovery of debt costs on competitive traffic.

- The opportunity cost concept employed in determining equity costs is also applicable to debt costs since railroad entities must earn the competitive market cost of debt to attract capital adequately.

- This methodology is compatible with the RAPB preference for measuring cost of capital on an industry basis for revenue adequacy purposes. Embedded debt costs may vary significantly among railroads, depending on the age composition of each railroad's debt.

- For practicality reasons, compensating for inflation through the use of a current nominal rate is preferable to use of a current cost asset base and a real rate. Computation of a real cost-of-capital rate requires an estimate of the expected rate of general inflation which cannot be observed.

## EFFECTS OF IMPLEMENTATION

Application of RAPB Principles to revenue adequacy determinations results in five departures from current ICC practices.[14]

### Definition of Control

One of the current ICC criteria for determining whether a subsidiary qualifies for inclusion in the railroad entity for revenue adequacy purposes is that the Class I railroad must own a majority interest in the subsidiary.

Control may exist even where majority ownership is not present. By defining affiliation in conformance with GAAP, the Entity Principle incorporates the GAAP concept of control rather than the majority ownership requirement of the ICC. For financial statement presentation, FASB is presently considering inclusion of affiliates which are less than majority owned. By determining affiliation as defined by GAAP, the Entity Principle permits flexibility to incorporate alternative measures of control which may be required in the future.[15]

The ICC presently requires consolidation/combination of Class I railroads that are under common control only if they form a unified, jointly managed system. The Entity Principle does not include this jointly managed condition for consolidation/combination. Whether elimination of this condition would result in a significant change in the present ICC entity for revenue adequacy is unclear.

### Inclusion of Activities Presently Excluded by the ICC

The railroad entity presently defined by the ICC includes only railroads and subsidiaries of Class I railroads. The railroad entity defined by the Entity Principle includes affiliated railroads and their

[14]Current ICC practices considered here represent changes resulting from the ICC's decision in Ex Parte No. 393 (Sub-No. 1), *supra*.

[15]GAAP on this issue is governed by AICPA Accounting Research Bulletin No 51, "Consolidated Financial Statements," which relies on majority ownership of a voting interest to determine controlling financial interest. A recent FASB exposure draft, "Consolidation of All Majority-Owned Subsidiaries," Dec. 16, 1986, states that the FASB is researching and deliberating on how to determine if means other than majority ownership result in control, but more consideration is needed before the FASB can reach tentative conclusions on this issue.

railroad-related affiliates. For example, the railroad entity defined by the Entity Principle may include subsidiaries of the holding company that would not be included by the ICC's definition.

The ICC does not include the results of noncontrolled interests for revenue adequacy purposes.

## The "But For" Test

Another of the current ICC criteria for determining whether a subsidiary qualifies for inclusion in the railroad entity is that a subsidiary's activities must be integral to the railroad's operations. If, "but for" the existence of the subsidiary, the railroad would have to create an operation to provide equivalent goods or services, the subsidiary is considered to be integral to the railroad's operations and is included in the railroad entity.[16]

While the Entity Principle does not include a "but for" test, its practical application uses a "but for" test. However, in defining the entity, both the RAPB's "but for" test and the point at which it applies, are different from the test used by the ICC.

To pass the "but for" test described by the RAPB, the revenue derived from or the support provided for railroad operations must be essential for the affiliate's existence. To pass the ICC's "but for" test, the operation, goods, or services provided by the railroad subsidiary must be essential for the railroad's operations.

To illustrate the difference between the two "but for" tests, assume a railroad owns and operates car repair facilities within the railroad company and also controls a subsidiary company which repairs cars for the parent railroad as well as for other nonaffiliated railroads. Further, assume that if the subsidiary company did not exist, the portion of the parent railroad's repairs which are presently performed by the subsidiary would be performed by distributing the work to the parent railroad's other repair facilities. The subsidiary company could fail a strict interpretation of the present ICC "but for" test because the railroad would not be required to create an operation to provide equivalent services. However, it would pass the RAPB's "but for" test, assuming the subsidiary company derived substantial revenue from the parent railroad, without which it could not exist.

## Use of GAAP Cost

The Asset Valuation and Related Expense Principle requires that assets be valued at GAAP cost for revenue adequacy determinations. However, the ICC may determine that GAAP cost is not a meaningful measure of value in certain circumstances and may elect to use another measure, such as predecessor cost.

[16]Ex Parte No. 393 (Sub-No. 1), *supra.*

# VERIFIED STATEMENT OF

# THOMAS N. HUND

**BEFORE THE**
**SURFACE TRANSPORTATION BOARD**

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**FINANCE DOCKET NO. 35506**

**WESTERN COAL TRAFFIC LEAGUE—**
**PETITION FOR DECLARATORY ORDER**

---

**VERIFIED STATEMENT OF**
**THOMAS N. HUND**

My name is Thomas N. Hund. I am Executive Vice President and Chief Financial Officer for BNSF Railway Company. I am responsible for all accounting, financial reporting, budgeting, financial and cost analysis, tax, treasury, real estate and other financial functions at BNSF Railway, its parent Burlington Northern Santa Fe, LLC and, prior to its acquisition by Berkshire Hathaway Inc. ("Berkshire Hathaway"), of Burlington Northern Santa Fe Corporation (the prior parent of BNSF Railway), all hereafter referred to as "BNSF".

I began my career in the railroad industry with Santa Fe Industries in 1983 in the accounting department. I was appointed Assistant Vice President and Controller for Santa Fe Railway in 1989. In 1990, I was promoted to Vice President and Controller of Santa Fe Railway and its parent, Santa Fe Pacific. I held that position until the merger with Burlington Northern in 1995, when I was appointed Vice President and Controller of BNSF. I became Chief Financial Officer of BNSF in 1999.

Prior to working in the railroad industry I worked at Peat Marwick (now known as KPMG), a large accounting firm, as an audit manager. I hold a Master of Business Administration from the University of Chicago and a Bachelor of Business Administration from Loyola University of Chicago. I am a Certified Public Accountant in Illinois.

In this statement I will discuss the appropriateness and application of Generally Accepted Accounting Principles ("GAAP") to BNSF after we were acquired by Berkshire Hathaway on February 12, 2010. I first will discuss why adherence to GAAP standards is important, widely accepted and appropriate in our situation. Second, I will discuss the rigorous process through which BNSF and Berkshire Hathaway applied GAAP purchase accounting to establish a new cost basis in BNSF's assets and liabilities. Third, I will discuss the results of that rigorous process and show that, contrary to claims made by some parties, none of the 31% "acquisition premium" that Berkshire Hathaway paid over the market value of BNSF's stock on the Agreement Date has any effect on the assets and liabilities that impact regulatory costs or rates. Finally, I will show that BNSF's policy and practice is to set its rates on the basis of demand, not costs, so it will be rare that any shipper's rates could be affected by the change in BNSF's net investment base.

**Generally Accepted Accounting Principles & Purchase Accounting Overview**

GAAP rules provide the foundation for consistent financial reporting in the United States. GAAP-based financial statements are necessary to provide comparability and consistency between reporting entities. The term "generally accepted" can mean either that an authoritative accounting rule-making body such as the U.S. Securities and Exchange Commission ("SEC") or the Financial Accounting Standards Board ("FASB") has established a principle of reporting in a given area or that over time a given practice has been accepted as appropriate because of its universal application. The SEC requires publicly traded and other regulated companies to follow GAAP for financial reporting. The SEC requires companies to follow GAAP because it allows investors, both large and small, sophisticated and unsophisticated, to evaluate the same information when making capital allocation decisions.

Purchase accounting is required under GAAP with rules codified by the FASB in Accounting Standards Codification (ASC) 805. Purchase accounting requires that for any acquisition, the purchase price for an entity be allocated to the assets and liabilities of the purchased entity. Purchase accounting rules state that a company's assets and liabilities are to be reflected at their "fair value" as of the transaction date. "Fair value," as defined by ASC 820, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between the market participants at the measurement date. Any excess of purchase price over the "fair value" of assets and liabilities is allocated to an intangible asset called goodwill.

In the past, with respect to certain business combinations, another method of accounting, the "pooling-of-interests method," was required under GAAP. Under the pooling-of-interests method, the assets and liabilities of the acquired entity essentially remained at book value and were combined with the acquiring entity in its consolidated financial statements. U.S. GAAP disallowed the use of the pooling method in 2001, and purchase accounting became the only method acceptable under GAAP and allowed by the SEC to account for acquisitions for the past decade.

**History of the Transaction**

BNSF was acquired by Berkshire Hathaway on February 12, 2010 ("Acquisition Date") as a result of an agreement dated November 2, 2009 ("Agreement Date"). Berkshire Hathaway paid $100 per share ($35 billion-purchase price) to acquire BNSF. This figure represented a premium of $24 per share to shareholders over the $76 market price ($26 billion-market value of equity) of BNSF shares on the Agreement Date and $62 per share more than the $38 per share ($13 billion) book value of BNSF equity on the Acquisition Date.

Consistent with GAAP and SEC requirements, BNSF assets and liabilities were valued following the Berkshire Hathaway purchase. As I will describe later, the BNSF acquisition resulted in $14 billion, or about two-thirds, of the excess of the purchase price over stockholders' equity being allocated to goodwill[1] and other items that do not affect regulatory costs. In contrast, previous transactions in the rail industry have seen write-ups of the respective railroad's physical plant of up to 100% of the premium paid and nothing allocated to goodwill.

**Application of Purchase Accounting**

As previously explained, purchase accounting is a technical accounting and regulatory practice. The acquisition of BNSF by Berkshire Hathaway required a purchase accounting valuation to be conducted. Neither BNSF nor Berkshire Hathaway had the expertise in the various valuation techniques required to assess the "fair value" of the assets and liabilities in order to allocate the purchase price among them for financial reporting purposes.

Berkshire Hathaway and BNSF went through a RFP process with valuation experts in order to identify the firm which would value the physical and intangible assets and liabilities of BNSF. The engagement for the valuation was awarded to Ernst & Young ("E&Y"), one of the largest accounting firms in the world. E&Y conducted a rigorous review of BNSF's physical and intangible assets and liabilities to determine a "fair value" of the assets and liabilities in accordance with ASC 805.

E&Y's activities included reviewing the physical condition of the hard assets and looking for synergistic opportunities with regard to the overall network of assets. As the BNSF rail network dates back more than 150 years and is the result of many mergers and acquisitions, it would be expected that the assemblage of the railroad contains some amount of duplicative

[1] Goodwill for the Berkshire Hathaway transaction is $15 billion offset by $1 billion of net liabilities not affecting BNSF Railway's regulatory costs.

routes. In the valuation process, an optimized network was planned and assessed by E&Y and BNSF; thus only the productive capacity of the railroad was considered in establishing the new book value for property, plant, and equipment.

As a result of the optimized network approach, some of BNSF's assets were written up while others were written down. As an example, the theoretically optimized rail network assigned no value to more than 6,600 route miles or about 30% of the network. Also, in the Railroad Safety Improvement Act of 2008, PTC (Positive Train Control) is required to be implemented by 2015 for U.S. railroads; as a result, economic obsolescence was identified for certain of BNSF's signal assets that were impacted by this act and thus written down. Much of the grading existing on the BNSF railroad at the acquisition dated back to the 1800's. In assessing a "fair value" of the grading on the optimized network, this category along with the real property received a write-up in value. Any excess or non-productive physical plant and equipment assets were assigned no value.

In addition, the valuation was conducted at a low point in the economic cycle which further reduced the amount allocated to hard assets. As an example, some assets, such as locomotives, were written down because they were determined to be excess (non-productive) on the Acquisition Date. The combined impact of the optimized network approach and the timing of the valuation in the economic cycle resulted in less of the purchase price of $35 billion being allocated to the physical assets and more to goodwill.

**Purchase Price Allocation**

| | |
|---|---|
| Property, Plant & Equipment | $13B |
| Deferred Income Tax Adjustments | $(-5)B |
| Net Assets Affecting BNSF Ry. Regulatory Costs | $8B |
| Net Assets Not Affecting BNSF Ry. Regulatory Costs, Primarily Goodwill | $14B |
| Total | $22B |

BNSF and Berkshire Hathaway's auditors, Deloitte & Touche, subsequently audited the valuation results. The purchase accounting adjustments were then recorded and included in both Berkshire Hathaway's and BNSF's annual 10-K filings with the SEC. The Berkshire Hathaway annual 10-K is signed and certified by Warren Buffett, Chairman – Principal Executive Officer and Marc Hamburg, Senior Vice President – Principal Financial Officer. The BNSF annual 10-K is signed and certified by Matt Rose, Chairman and Chief Executive Officer and me.

**Results**

Berkshire Hathaway paid $62 per share or a total of $22 billion over the book value of BNSF. This can be derived by subtracting BNSF's $38 per share book value from the $100 per share paid by Berkshire Hathaway. However, prior to the Berkshire Hathaway Agreement Date, the market had already determined that BNSF's value as a going concern, as reflected in the $76 per share market price on the Agreement Date, greatly exceeded its book value. This is important because, as demonstrated in the chart below, every dollar paid by Berkshire Hathaway in excess of that $76 per share market price was attributed to goodwill, and had no effect at all on BNSF's regulatory asset base, since goodwill is not included there. Even if Berkshire Hathaway were to have paid a significantly higher price, BNSF's valuation methodology would have

attributed the entire additional amount to goodwill, which would have had no effect on the value of BNSF's physical plant.

The chart below shows that BNSF's book value was $13 billion or $38 per share while its market value immediately prior to Berkshire Hathaway's purchase was $26 billion or $76 per share. This represented a market premium over the book value of BNSF of $13 billion. The purchase price paid by Berkshire Hathaway for BNSF was $35 billion or $100 per share, for a premium over the book value of $22 billion. Only $8 billion of the $22 billion total premium over book value was allocated to the assets and liabilities that impact regulatory costs, while the remainder of $14 billion was attributed to net assets that do not affect regulatory costs, primarily goodwill. Berkshire Hathaway paid $9 billion more that the market value of BNSF in the acquisition; therefore, $5 billion of goodwill was already included in BNSF's market value prior to the Berkshire Hathaway purchase.

***Comparison of book value to market value to Berkshire Hathaway acquisition price (all values in billions except per share value):***

| | Book Value of Equity | Equity Value on Agreement Date (11/02/2009) | BRK Acqusition |
|---|---|---|---|
| **Per Share** | $38 | $76 | $100 |
| **Total Value (in Billions)** | $13 | $26 | $35 |
| **Premium over Book** | | $13 | $22 |
| **BRK Premium over Market** | | | $9 |
| **Net Asset Write up Impacting BNSF Ry. Regulatory Costs** | | $8 | |
| **Goodwill[1] Implied by the Market** | | $5 | |
| **Goodwill[1] Implied by BRK Premium over Market** | | | $9 |
| **Total Goodwill[1] Write up** | | $14 | |

[1] Goodwill is $15 billion offest by $1 billion of net liabilities not affecting BNSF Railway regulatory costs.

## Impact on BNSF Customers

A number of trade associations and a few of BNSF's customers have asserted that the purchase accounting adjustment will allow BNSF to increase freight rates and customers will have to absorb the premium paid for BNSF by Berkshire Hathaway. Some have also asserted that the acquisition and the application of GAAP will allow BNSF, as a general matter, to charge higher maximum lawful rates. Based on my experience at BNSF, including being a member of BNSF's Executive Team as well as its internal pricing council, I do not believe these assertions to be correct.

BNSF's policy and practice is to set its rates based upon market demand, not costs. Accordingly, the GAAP purchase accounting adjustments to BNSF's assets and liabilities will not directly translate into BNSF imposing any rate increases. Nor will BNSF's customers be

forced to pay for the acquisition through higher rates as a result of the application of purchasing accounting as required by GAAP.

However, out of thousands of BNSF customers and hundreds of thousands of contract and common carrier rates, BNSF does have one current instance where a customer has a rate prescription set by the STB in the form of revenue (R) to variable cost (VC) ratios. It is true that, in this unique situation, the purchase adjustments may alter BNSF's URCS costs for regulatory purposes and therefore have a modest effect on the rates that those R/VC ratios translate into. If the Board is concerned about the effect on those customer rates, I would encourage the Board to directly address those rare situations rather than alter over two decades of precedent and change its policies regarding the application of GAAP accounting.

In this statement I have discussed the appropriateness and application of GAAP to BNSF after we were acquired by Berkshire Hathaway on February 12, 2010. I explained why adherence to GAAP standards is important, widely accepted and appropriate in our situation. I explained the rigorous process through which BNSF and Berkshire Hathaway applied GAAP purchase accounting to establish a new cost basis to BNSF's assets and liabilities. Additionally, I described the results of that rigorous process and showed that, contrary to claims made by some parties, none of the 31% acquisition premium paid by Berkshire Hathaway has any effect on the assets and liabilities that impact regulatory costs or rates. Finally, I showed that BNSF's policy and practice is to set its rates on the basis of demand, not costs, so it will be rare that any shipper's rates could be affected by the change in BNSF's net investment base.

## VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on October 27, 2011

Thomas N. Hund

# VERIFIED STATEMENT OF

# MICHAEL R. BARANOWSKI
# AND
# BENTON V. FISHER

**BEFORE THE**
**SURFACE TRANSPORTATION BOARD**

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**FINANCE DOCKET NO. 35506**

**WESTERN COAL TRAFFIC LEAGUE—**
**PETITION FOR DECLARATORY ORDER**

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**JOINT VERIFIED STATEMENT**
**of**
**MICHAEL R. BARANOWSKI**
**and**
**BENTON V. FISHER**

**Introduction**

We are Michael R. Baranowski and Benton V. Fisher. We are Senior Managing Directors in FTI Consulting's Network Industries Strategies practice with offices at 1101 K Street, NW, Washington, DC 20005. Statements of our qualifications are set forth in Exhibits 1 and 2, respectively. We have been asked by BNSF Railway Company ("BNSF") to comment on the regulatory effects of the application of GAAP purchase accounting to value BNSF's investment base.

In Section I we quantify the amount of the purchase accounting adjustment that will be reflected in the BNSF 2010 URCS and calculate the amount of change in BNSF's 2010 URCS costs associated with purchase accounting. In Section II we compare the effect of the Berkshire purchase accounting adjustment on BNSF net investment to adjustments resulting from other carrier acquisitions. In Section III we demonstrate that the effects of the purchase accounting adjustment on URCS are small and that the percentage of BNSF shipments that would change from being subject to Board regulation to falling below the jurisdictional threshold level is even

smaller. In Section IV we show the effects of the purchase accounting adjustment on revenue adequacy calculations for BNSF. In Section V we estimate the effects of the purchase accounting adjustment on BNSF's RSAM.

## I. Effects of Purchase Accounting Adjustment on BNSF 2010 URCS

The Board in its September 28 decision asked for comments on the effect of the purchase accounting write-up of BNSF's net investment base on the annual URCS variable cost and revenue adequacy calculations. We first looked to the calculations of BNSF's accountants to determine the extent to which the purchase accounting adjustments raised BNSF's net investment base. Table 1 below shows by R-1 schedule and line number the amount of the purchase accounting adjustment reported in the 2010 BNSF R-1 and reflected in URCS.

Table 1

| Summary of Berkshire Purchase Accounting Adjustment on URCS Net Investment ($ millions) | | | | |
|---|---|---|---|---|
| R-1 Schedule | Line & Column | Line/Schedule Description | Source | Amount Captured in URCS |
| **Assets:** | | | | |
| 330 | 43 (d) | Gross Investment, Grand Total | R-1 | $1,312 |
| 335 | 41 (f) | Accumulated Depreciation, Grand Total | R-1 | $11,334 |
| **Subtotal Assets** | | | | **$12,646** |
| **Liabilities:** | | | | |
| 200 | 49 (b) | Accumulated Deferred Income Tax Credits | Work papers | $4,507 |
| **Subtotal Liabilities** | | | | **$4,507** |
| **Adjustment to URCS Net Investment** | | | | **$8,139** |

Thus, of the total $22 billion premium paid by Berkshire over the book value of BNSF equity, only $8 billion – less than 40 percent – is included in BNSF's net investment for URCS purposes.

In addition to its effects on the BNSF balance sheet, the purchase accounting adjustment produced slightly higher annual depreciation expenses, due primarily to writing up the grading, bridges and computer systems account balances. Table 2 below summarizes the effects of the purchase accounting adjustment on BNSF 2010 annual depreciation.

Table 2

| Purchase Accounting Adjustment Effect on BNSF Annual Depreciation Expense ($ millions) | |
|---|---|
| **Description** | **Difference** |
| Road Accounts | ($89) |
| Equipment Accounts | (67) |
| Computer Systems | 217 |
| **Total** | **$61** |
| **Adjustment % of Total 2010 Depreciation Expense** | **3%** |

Finally, as reported by BNSF in its Quarterly Reports of Fuel Cost, Consumption and Fuel Surcharge Revenue, BNSF reduced the amount of its fuel cost – an URCS operating expense – by $50 million in 2010 to account for adjustments for fuel hedges resulting from the Berkshire acquisition.[1] This adjustment represented a 2-percent decrease to BNSF 2010 fuel expense of $2.9 billion.

With respect to the direct effect of the purchase accounting adjustment on BNSF's URCS costs, because the Board has not yet released its 2010 URCS, we created a 2010 URCS using BNSF's R-1 report and other publicly available data.[2] We then calculated the effect of the

[1] *See* BNSF's quarterly Fuel Surcharge reports submitted to the STB and BNSF's 10-K.
[2] As we are not able to perform all of the calculations that the STB does when it generates the official URCS datasets. these URCS variable costs may not match precisely those that would be generated by the STB.

purchase accounting adjustments on variable costs using the approach taken by the STB in *CSX Corp., Et Al.—Control—Conrail Inc., Et Al.*, 3 S.T.B.196, 263-64 and App. N (1998) that applied URCS variabilities to the way and structures, equipment, depreciation and fuel components of the adjustment and identified the portion of BNSF 2010 URCS variable costs associated with the purchase accounting adjustments. We determined that the purchase accounting adjustment resulted in an overall increase in BNSF's system-wide 2010 URCS variable costs of 5.6 percent.[3] The effect on BNSF 2010 URCS is near the low end of the range of the effect on URCS that the STB determined in *Conrail*, which was 4.9 to 7.3 percent.

## II. The Change in BNSF Net Investment Produced by the Purchase Accounting Adjustment is Smaller Than the Changes Resulting from Virtually All Other Recent Railroad Acquisitions

In order to put the recent BNSF purchase accounting adjustment into perspective, we used R-1 Annual Report data to compute the percentage effect of the asset write-up on the net investment in road property and equipment of the acquired entity from prior railroad acquisitions. Net investment was calculated as the total gross investment in road and equipment property (from R-1 Schedule 330), less the total accumulated depreciation (Schedule 335), less the accumulated deferred tax credits (Schedule 200). Because NS and CSXT initially reported their acquisitions of the relative proportions of Conrail as a lease, the amount reported in R-1 Schedule 332 for 1999 for NS and CSXT was compared to the relative proportion of the Conrail net investment from the Conrail 1999 R-1. While we recognize that the R-1 data is not limited to the effects of any purchase accounting adjustments and includes other changes in net investment related to normal year-to-year transactions, the R-1 data provide a reasonable basis for

[3] Details of our calculations are summarized in Exhibit 3 and included in our work papers.

comparison across carriers.[4] Table 3 below compares the relative changes in net investment resulting from prior acquisitions.

Table 3

| Effects on Net Investment from Recent Acquisitions, from Reported R-1 Information ($ millions) | | | | | |
|---|---|---|---|---|---|
| **Transaction** | **Acquired Entity** | **R-1 Reporting Year** | **Pre-Acquisition Net Investment** | **Post-Acquisition Net Investment** | **Percentage Change** |
| BNSF Berkshire | BNSF | 2010 | $23,081 | $32,056 | 39% |
| | | | | | |
| CN and IC | IC | 2002 | $1,161 | $4,509 | 288% |
| NS and Conrail | Conrail | 1999 | $3,188 | $4,553 | 43% |
| CSXT and Conrail | Conrail | 1999 | $2,308 | $3,248 | 41% |
| UP and SP | SP | 1997 | $4,551 | $7,901 | 74% |
| BN and ATSF | ATSF | 1995 | $3,812 | $6,564 | 72% |
| CNW Blackstone | CNW | 1989 | $959 | $1,111 | 16% |

## III. Effects of Purchase Accounting Adjustment on Traffic Subject to STB Regulation

WCTL in its petition complained that increases in BNSF's URCS variable costs could effectively reduce some shippers' rates below the jurisdictional threshold of 180% of variable cost, which would prevent them from bringing rate cases and raise the floor on the maximum rate prescriptions. These complaints are exaggerated. First, using a version of BNSF's own 2010 traffic and revenue file, stripped down to include only those shipments potentially subject to Board jurisdiction and then only those inputs required to develop URCS variable costs, we calculated the extent to which any non-contract regulated traffic that today produces R/VC ratios above 180% would move below the jurisdictional threshold as a result of the purchase accounting write-up of BNSF's investment base. We determined that out of the 9.1 million revenue movements involving thousands of shippers, less than 2 percent are regulated

[4] For two transactions, CN-IC and UP-SP, the purchase accounting adjustment was first reported in a consolidated R-1. For those, we estimated the pre-acquisition net investment for IC and SP, respectively. Details of our calculations are included in our work papers.

movements that would move from above to below the jurisdictional threshold.[5] Moreover, the practical impact of this shift would be negligible. Rates near the jurisdictional threshold are not often the subject of rate cases. In only a few instances has the jurisdictional threshold served as a floor on a maximum rate prescription.

## IV. Effects of Purchase Accounting Adjustment on BNSF 2010 Revenue Adequacy

With respect to the impact on revenue adequacy, we used the STB's standard approach to calculating revenue adequacy and applied the Board's determination of the 2010 cost of capital (served October 3, 2011) to BNSF's investment base both with and without the purchase accounting adjustments. Either way, BNSF was revenue inadequate for 2010. There was a difference of only 4.4 percent between the revenue that BNSF would have to collect in order to achieve revenue adequacy without the purchase accounting adjustments and the revenue it requires to achieve revenue adequacy with the purchase accounting adjustments.[6] As to the effect of this, as the Board pointed out in *Conrail*, neither the Board nor the ICC has ever decided a maximum rate case based upon whether a railroad was or was not revenue adequate. Moreover, insofar as revenue adequacy might ever constitute a constraint on a railroad's rates, as the Board also pointed out, it is all the more important that railroads be given the opportunity to be compensated for the current value of their property, not just net investment.

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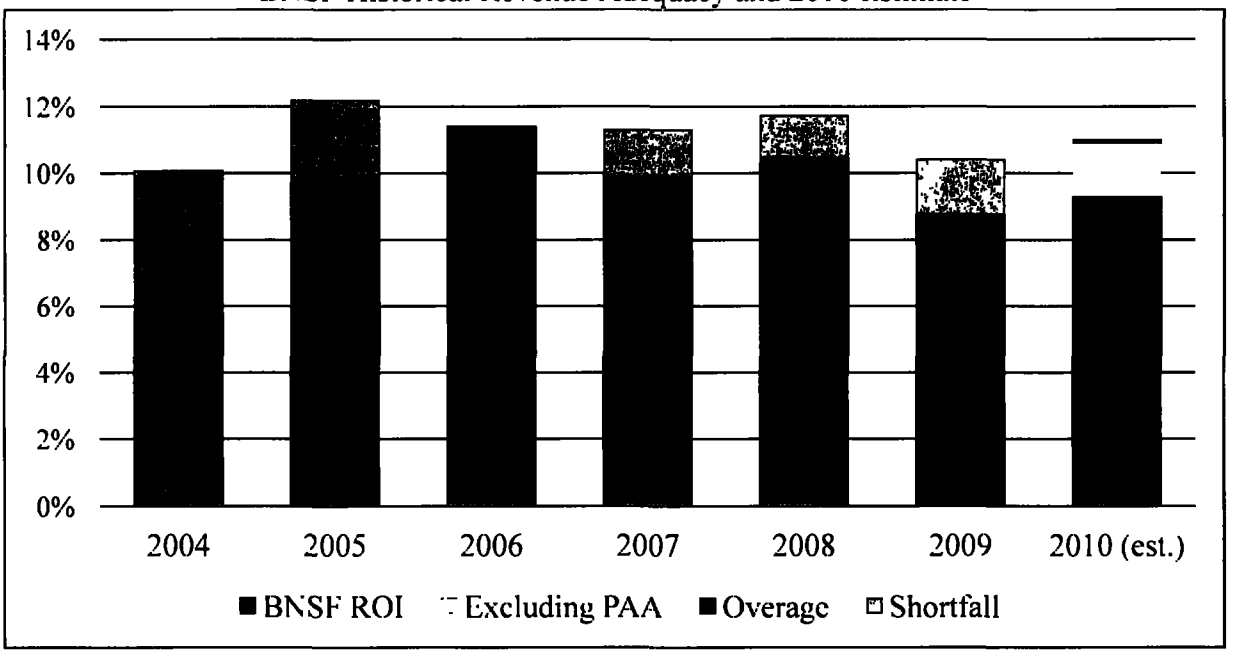
[5] Details of our calculations are summarized in our workpapers.

[6] Details of our calculations are summarized in our workpapers. Because the Board's revenue adequacy calculations use the average of the beginning and ending year net investment, the full effect of the Berkshire purchase accounting adjustment will not be reflected in the revenue adequacy calculations until 2012.

Chart 1 below compares BNSF historical revenue adequacy performance over the 2004 through 2010 time frame and shows that BNSF has consistently fallen short of achieving revenue adequacy under the Board's revenue adequacy standard.

Figure 1
BNSF Historical Revenue Adequacy and 2010 Estimate




## V. Effects of Purchase Accounting Adjustment on RSAM

As outlined in the prior section, BNSF will not be found to be revenue adequate by the Board for 2010, whether or not the purchase accounting adjustment is reflected in the net investment. Because outcomes under the Board's procedures for small rate cases that utilize the Three Benchmark test[7] are potentially affected by whether or not the purchase accounting adjustment is included in the BNSF net investment, we have been asked to estimate the effect of the purchase accounting adjustment on the BNSF RSAM.

The RSAM benchmark is intended to measure the average markup above variable cost that a railroad would need to realize on traffic moving at R/VC ratios above 180% to achieve

[7] *See Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007).

revenue adequacy. We estimated the BNSF 2010 RSAM both with and without the effects of the purchase accounting adjustment using BNSF full year 2010 traffic and revenue data and the 2010 URCS that we developed. We then calculated the average ratio of the RSAM to the average R/VC greater than 180 for 2007 through 2010 that would apply in a Three Benchmark case filed after the 2010 Carload Waybill Sample was made available by the Board, based on the preliminary estimate of the 2010 figures and the 2007-2009 factors published by the STB.[8] Table 4 below summarizes those results and shows that the average RSAM-to-R/VC > 180 ratio is 5.0 percent higher when the purchase accounting adjustment is included.[9]

Table 4

| Effects of Purchase Accounting Adjustment on Estimate of 2007-2010 BNSF RSAM | | | | | |
|---|---|---|---|---|---|
| | **2007-2010 Average** | **2010 Estimate** | **2009 STB** | **2008 STB** | **2007 STB** |
| *As reported* | | | | | |
| RSAM | { } | { } | 253% | 242% | 254% |
| R/VC > 180 | { } | { } | 221% | 221% | 232% |
| RSAM / RVC > 180 Ratio | 1.141 | | | | |
| *Excluding Purchase Accounting Adjustment* | | | | | |
| RSAM | { } | { } | N/A | | |
| R/VC > 180 | { } | { } | | | |
| RSAM / RVC > 180 Ratio | 1.086 | | | | |

As with our quantification of the effect on URCS variable costs, these results are based on our preliminary calculations of BNSF 2010 URCS costs. It bears further noting that there are also other sources of differences between these results and those that would be generated by the

[8] *See Simplified Standards for Rail Rate Cases—2009 RSAM and R/VC>180 Calculations*, EP 689 (Sub-No. 2) (STB served July 14, 2011).

[9] BNSF notes that even with the effect of purchase accounting, the estimate of BNSF's 2007-2010 RSAM-to-R/VC >180 ratio remains below the ratios last published by the STB for all but one other Class I carrier.

STB. The STB determines the RSAM and related factors based on the subset of each carrier's traffic that is included in the annual Carload Waybill Sample. As the 2010 Waybill Sample is not yet available, we performed our calculations based on the full – "100%" – BNSF traffic files for 2010, and used inputs that may not match those that will be used in the STB's calculations.[10] Further, it is difficult to estimate the impact that the Berkshire purchase accounting would have on Three-Benchmark cases, as BNSF has not been the subject of any such challenges. However, in Three Benchmark cases involving other railroads, the outcome often turns on the selection of the comparison group, which is a process that relates to factors that reflect demand and other characteristics of the shipments, rather than R/VC calculations.

[10] For example, we based our variable cost calculations on the actual loaded miles on BNSF rail lines: the STB's process uses miles for the entire movement from PCRail.

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Supplemental Finance Studies, Kean College

**Mike Baranowski** provides financial financial and economic consulting services to the telecommunications and transportation industries. He has special expertise in analyzing and developing complex computer costing models, operations analysis, and transportation engineering. Much of his work involves providing oral and written expert testimony before courts and regulatory bodies.

Some of Mr. Baranowski's representative accomplishments include:

- Overseeing the development of computer cost modeling tools designed to simulate the cost of competive entry into local telecommunications markets and directing the efforts of a nationwide team of testifying experts presenting the cost model results in multiple proceedings across the country.
- Directing the analysis, critique and restatement of a variety of complex cost models developed by major telecommunications companies designed to simulate the forward-looking cost of competitive entry into local telecommunications markets.
- Designing multiple PC-based spreadsheet models for use in calculating the stand-alone cost of competitive entry into the railroad and pipeline markets. These models have been used to assist clients in all three network industries in making internal pricing decisions that are in compliance with governing regulatory standards.
- Conducting detailed analyses of railroad operations and developing the associated capital requirements and operating expenses attributable to specific movements and the incremental capital and operating expense requirements attributable to major changes in anticipated traffic levels.
- Calculating marginal and incremental costs for a major petroleum products pipeline company, an approach that is now used regularly by the company in making internal day-to-day pricing decisions.

Mr. Baranowski holds a B S. in Accounting from Fairfield University in Fairfield, Connecticut and has pursued supplemental finance studies at Kean College in Union, New Jersey.

## TELECOMMUNICATIONS TESTIMONY

*Federal Communications Commission*

| | |
|---|---|
| February 1998 | File No. E-98-05. AT&T Corp. v. Bell Atlantic Corp. Affidavit of Michael R. Baranowski. |
| March 13, 1998 | File No. E-98-05. AT&T Corp. v. Bell Atlantic Corp. Supplemental Affidavit of Michael R. Baranowski. |
| June 10, 1999 | CC Docket No. 96-98. Implementation of the Local Competition Provisions of the Telecommunications Act of 1996. Reply Affidavit of Michael R. Baranowski, John C. Klick and Brian F. Pitkin. |

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| July 25, 2001 | CC Docket No. 00-251, 00-218. In the Matter of Petition of AT&T Communications of Virginia, Inc. and WorldCom, Inc., Pursuant to Section 252(e)(5) of the Communications Act, for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon-Virginia, Inc. Panel |
| June 13, 2005 | WC Docket No. 05-25;RM-10593. In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, Joint Declaration on Behalf of SBC Communications, Inc. |
| July 29, 2005 | WC Docket No. 05-25;RM-10593. In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, Joint Reply Declaration on Behalf of SBC Communications, Inc. |

*Public Service Commission of Delaware*

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| February 4, 1997 | PSC Docket No. 96-324. In the Matter of Bell Atlantic - Delaware Statement of Terms and Conditions Under Section 252(F) of the Telecommunications Act of 1996. Testimony of Michael R. Baranowski. |

*Public Service Commission of the District of Columbia*

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| March 24, 1997 | Formal Case No. 962. In the Matter of the Implementation of the District of Columbia Telecommunications Competition Act of 1996. Testimony of Michael R. Baranowski. |
| May 2, 1997 | Formal Case No. 962. In the Matter of the Implementation of the District of Columbia Telecommunications Competition Act of 1996. Rebuttal Testimony of Michael R. Baranowski. |

*Public Service Commission of the State of Maryland*

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| March 7, 1997 | Docket No. 8731, Phase II. In the Matter of the Petitions for Approval of Agreements and Arbitration of Unresolved Issues Arising Under Section 252 of the Telecommunications Act of 1996. Direct Testimony of Michael R. Baranowski. |
| April 4, 1997 | Docket No. 8731, Phase II. In the Matter of the Petitions for Approval of Agreements and Arbitration of Unresolved Issues Arising Under Section 252 of the Telecommunications Act of 1996. Rebuttal Testimony of Michael R. Baranowski. |
| May 25, 2001 | Case No. 8879. In the Matter of the Investigation into Rates for Unbundled Network Elements Pursuant to the Telecommunications Act of 1996. Panel Testimony on Recurring Cost Issues |

*Public Service Commission of the State of Michigan*

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| January 20, 2004 | Case No. U-13531. In the Matter, on the Commission's Own Motion to Review the Costs of Telecommunication Service Provided By SBC Michigan. Initial Testimony of Michael R. Baranowski and Julie A. Murphy. |
| May 10, 2004 | Case No. U-13531. In the Matter, on the Commission's Own Motion to Review the Costs of Telecommunication Service Provided By SBC Michigan. Final Reply Testimony of Michael R. Baranowski and Julie A. Murphy. |

*New Jersey Board of Public Utilities*

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| December 20, 1996 | Docket No. TX 95120631. Notice of Investigation Local Exchange Competition for Telecommunications Services. Rebuttal Testimony of John C. Klick and Michael R. Baranowski. |

*North Carolina Utilities Commission*

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| March 9, 1998 | Docket No. P-100, Sub 133d. In the Matter of Establishment of Universal Support Mechanisms Pursuant to Section 254 of the Telecommunications Act of 1996. Rebuttal Testimony of Michael R. Baranowski. |

*Pennsylvania Public Utility Commission*

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| January 13, 1997 | Docket Nos. A-310203F0002 et al. MFS-III. Application of MFS Intelenet of Pennsylvania, Inc. et. Al. (Phase III). Rebuttal Testimony of Michael R. Baranowski. |
| February 21, 1997 | Docket Nos. A-310203F0002 et al. MFS-III. Application of MFS Intelenet of Pennsylvania, Inc. et. Al. (Phase III). Surrebuttal Testimony of Michael R. Baranowski. |
| April 22, 1999 | Docket Nos. P-00991648, P-00991649. Petition of Senators and CLECs for Adoption of Partial Settlement and Joint Petition for Global Resolution of Telecommunications Proceedings. Direct Testimony of Michael R. Baranowski. |
| January 11, 2002 | Docket No. R-00016683. Generic Investigation of Verizon Pennsylvania, Inc.'s Unbundled Network Element Rates. Panel Testimony on Recurring Cost Issues |

*State Corporation Commission Commonwealth of Virginia*

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| April 7, 1997 | Case No. PUC970005. Ex Parte to Determine Prices Bell Atlantic - Virginia, Inc. Is Authorized To Charge Competing Local Exchange Carriers In Accordance With The Telecommunications Act of 1996 And Applicable State Law. Affidavit of Michael R. Baranowski. |
| April 23, 1997 | Case No. PUC970005. Ex Parte to Determine Prices Bell Atlantic - Virginia, Inc. Is Authorized To Charge Competing Local Exchange Carriers In Accordance With The Telecommunications Act of 1996 And Applicable State Law. Direct Testimony of Michael R. Baranowski. |

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| June 10, 1997 | Case No. PUC970005. Ex Parte to Determine Prices Bell Atlantic - Virginia, Inc. Is Authorized To Charge Competing Local Exchange Carriers In Accordance With The Telecommunications Act of 1996 And Applicable State Law. Rebuttal Testimony of Michael R. Baranowski. |

*Washington State Utilities and Transportation Commission*

| | |
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| December 22, 2003 | Docket No. UT-033044. In the Matter of the Petition of Qwest Corporation To Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order. Direct Testimony of Michael R. Baranowski. |
| February 2, 2004 | Docket No. UT-033044. In the Matter of the Petition of Qwest Corporation To Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order. Response Testimony of Michael R. Baranowski. |

*Public Service Commission of West Virginia*

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| February 13, 1997 | Case Nos. 96-1516-T-PC, 96-1561-T-PC, 96-1009-T-PC, 96-1533-T-T. Petition to establish a proceeding to review the Statement of Generally Available Terms and Conditions offered by Bell Atlantic in accordance with Sections 251, 252, and 271 of the Telecommunications Act of 1996. Testimony of Michael R. Baranowski. |
| February 27, 1997 | Case Nos. 96-1516-T-PC, 96-1561-T-PC, 96-1009-T-PC, 96-1533-T-T. Petition to establish a proceeding to review the Statement of Generally Available Terms and Conditions offered by Bell Atlantic in accordance with Sections 251, 252, and 271 of the Telecommunications Act of 1996. Rebuttal Testimony of Michael R. Baranowski. |
| June 3, 2002 | Case No. 01-1696-T-PC, Verizon West Virginia, Inc. Petition For Declaratory Ruling That Pricing of Certain Additional Unbundled Network Elements (UNEs) Complies With Total Element Long-Run Incremental Cost (TELRIC) Principles. Direct Testimony of Michael R. Baranowski |
| July 1, 2002 | Case No. 01-1696-T-PC, Verizon West Virginia, Inc. Petition For Declaratory Ruling That Pricing of Certain Additional Unbundled Network Elements (UNEs) Complies With Total Element Long-Run Incremental Cost (TELRIC) Principles. Supplemental Direct Testimony of Michael R. Baranowski |

**RAILROAD TESTIMONY**

*Interstate Commerce Commission*

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| March 9, 1995 | Finance Docket No. 32467. National Railroad Passenger Corporation and Consolidated Rail Corporation -- Application Under Section 402(a) of the Rail Passenger Service Act for an Order Fixing Just Compensation. |
| October 30, 1995 | Docket No. 41185. Arizona Public Service Company and Pacificorp v. The Atchison, Topeka and Santa Fe Railway Company. |

*Surface Transportation Board*

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| July 11, 1997 | Docket No. 41989. Potomac Electric Power Company v. CSX Transportation, Inc. Reply Statement and Evidence of Defendant CSX Transportation, Inc. |
| August 14, 2000 | Docket No. 42051. Wisconsin Power and Light Company v. Union Pacific Railroad Company, Reply Verified Statement of Christopher D. Kent and Michael R. Baranowski. |
| September 20, 2002 | STB Docket No. 42070. Duke Energy Corporation v. CSX Transportation, Inc., Reply Evidence and Argument of CSX Transportation, Inc. |
| September 30, 2002 | STB Docket No. 42069. Duke Energy Corporation v. Norfolk Southern Railway Company, Reply Evidence and Argument of Norfolk Southern Railway Company. |
| October 11, 2002 | STB Docket No. 42072. Carolina Power & Light v. Norfolk Southern Railway Company, Reply Evidence and Argument of Norfolk Southern Railway Company. |
| November 12, 2002 | Docket No. 42070 Duke Energy Corporation v. CSX Transportation, Rebuttal Evidence and Argument of CSX Transportation |
| November 19, 2002 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Rebuttal Evidence and Argument of Norfolk Southern Railway Company |
| November 27, 2002 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Rebuttal Evidence and Argument of Norfolk Southern Railway Company |
| January 10, 2003 | STB Docket No. 41185. Arizona Public Service Co. And Pacificorp v. The Atchison, Topeka and Santa Fe Railway Company, Petition of the Burlington Northern and Santa Fe Railway Company to Reopen and Vacate Rate Prescription. |
| February 19, 2003 | STB Docket No. 42077, Arizona Public Service Co. And Pacificorp v. The Burlington Northern and Santa Fe Railway Company, and STB Docket No. 41185, Arizona Public Service Co. And Pacificorp v. The Burlington Northern and Santa Fe Railway Company, Reply of the Burlington Northern Santa Fe Railway Company in Opposition to Petition for Consolidation. |
| April 4, 2003 | Docket No. 42057 Public Service Company of Colorado D/B/A Xcel Energy v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence and Argument of The Burlington Northern and Santa Fe Railway Company |
| October 8, 2003 | Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| October 24, 2003 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Supplemental Evidence of Norfolk Southern Railway Company |

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| October 31, 2003 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Reply of Norfolk Southern Railway Company to Duke Energy Company's Supplemental Evidence |
| November 24, 2003 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Supplemental Evidence of Norfolk Southern Railway Company |
| December 2, 2003 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Reply of Norfolk Southern Railway Company to Carolina Power & Light Company's Supplemental Evidence |
| December 12, 2003 | Docket No. 42069 Reply of Norfolk Southern Railway Company to Duke Energy Corporation's Petition to Correct Technical Error and Affidavit of Michael R. Baranowski |
| January 5, 2004 | Docket No. 42070 Duke Energy Corporation v. CSX Transportation, Inc., Supplemental Evidence of CSX Transportation, Inc. |
| January 26, 2004 | Docket No. 42058 Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad Company, Joint Supplemental Reply Evidence and Argument of The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad Company |
| March 22, 2004 | Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Supplemental Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| April 9, 2004 | Docket No. 41185 Arizona Public Service Company and Pacificorp v. The Burlington Northern and Santa Fe Railway Company, The Burlington Northern and Santa Fe Railway Company's Reply Evidence on Reopening |
| May 24, 2004 | Docket No. 41191 (Sub-No 1) AEP Texas North Company v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| June 23, 2004 | Docket No. 42057 Public Service Company of Colorado d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Railway Company, Petition to Correct Technical and Computational Errors |
| March 1, 2005 | Docket No. 42071 Otter Tail Power Company v BNSF Railway Company, Supplemental Evidence of BNSF Railway Company |
| April 4, 2005 | Docket No. 42071 Otter Tail Power Company v BNSF Railway Company, Reply of BNSF Railway Company to Supplemental Evidence |
| July 20, 2005 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Reply Evidence of BNSF Railway Company |
| May 1, 2006 | Docket No. Ex Parte 657 (Sub-No. 1) Major Issues in Rail Rate Cases, Verified Statement Supporting Comments of BNSF Railway Company |

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| May 31, 2006 | Ex Parte 657 (Sub-No. 1) Major Issues in Rail Rate Cases; Verified Statement Supporting Reply Comments of BNSF Railway Company |
| June 15, 2006 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Reply Supplemental Evidence of BNSF Railway Company |
| June 15, 2006 | Docket No. 41191 (Sub 1) AEP Texas North Company v. BNSF Railway Company, Reply Supplemental Evidence of BNSF Railway Company |
| June 30, 2006 | Docket No. Ex Parte 657 (Sub-No. 1) Major Issues in Rail Rate Cases; Verified Statement Supporting Rebuttal Comments of BNSF Railway Company |
| February 4, 2008 | Docket No. 42099 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc , Opening Evidence of CSX Transportation, Inc. |
| February 4, 2008 | Docket No. 42100 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Opening Evidence of CSX Transportation, Inc. |
| February 4, 2008 | Docket No. 42101 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Opening Evidence of CSX Transportation, Inc. |
| May 1, 2008 | Docket No. Ex Parte 679 Petition of the AAR to Institute a Rulemaking Proceeding to Adopt a Replacement Cost Methodology to Determine Railroad Revenue Adequacy, Verified Statement of Michael R. Baranowski |
| July 14, 2008 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc v BNSF Railway Company, Third Supplemental Reply Evidence of BNSF Railway Company |
| July 14, 2008 | Docket No. AB-515 (Sub-No. 2) Central Oregon & Pacific Railroad, Inc. -- Abandonment and Discontinuance of Service -- in Coos, Douglas, and Lane Counties, Oregon (Coos Bay Rail Line) |
| August 8, 2008 | Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. BNSF Railway Company, Fourth Supplemental Evidence of BNSF Railway Company |
| August 11, 2008 | Docket No. 42014 Entergy Arkansas, Inc. and Entergy Services, Inc. v Union Pacific Railroad Company and Missouri & Northern Arkansas Railroad Company, Inc.; Finance Docket No. 32187 Missouri & Northern Arkansas Railroad Company, Inc. – Lease, Acquisition and Operations Exemption – Missouri Pacific Railroad Company and Burlington Northern Railroad Company, Reply Evidence and Argument of Union Pacific |
| September 5, 2008 | Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. BNSF Railway Company, Fourth Supplemental Reply Evidence of BNSF Railway Company |
| September 12, 2008 | Docket No. AB-515 (Sub-No. 2) Central Oregon & Pacific Railroad, Inc. -- Abandonment and Discontinuance of Service -- in Coos, Douglas, and Lane Counties, Oregon (Coos Bay Rail Line); Rebuttal to Protests |
| August 24, 2009 | Docket No. 42114 US Magnesium, L.L.C. v. Union Pacific Railroad Company, Opening Evidence of Union Pacific Railroad Company |
| October 22, 2009 | Docket No. 42114 US Magnesium, L.L.C. v. Union Pacific Railroad Company, Rebuttal Evidence of Union Pacific Railroad Company |

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| January 19, 2010 | Docket No. 42110 Seminole Electric Cooperative, Inc. v. CSX Transportation, Inc., Reply Evidence of CSX Transportation, Inc. |
| May 7, 2010 | Docket No. 42113 Arizona Electric Power Cooperative, Inc. v. BNSF Railway Company and Union Pacific Railroad Company, Joint Reply Evidence of BNSF Railway Company and Union Pacific Railroad Company |
| November 22, 2010 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc v. BNSF Railway Company, BNSF Comments on Remand, Joint Verified Statement of Michael R Baranowski and Benton V. Fisher |
| January 6, 2011 | Docket No. 42056 Texas Municipal Power Agency v. BNSF Railway Company, BNSF Reply to TMPA Petition for Enforcement of Decision, Joint Verified Statement of Michael R. Baranowski and Benton V. Fisher |

*US District Court for Northern District of Oklahoma*

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| January 2, 2007 | Case No. 06-CV-33 TCK-SAJ, Grand River Dam Authority v. BNSF Railway Company; Report of Michael R. Baranowski |
| February 2, 2007 | Case No. 06-CV-33 TCK-SAJ, Grand River Dam Authority v. BNSF Railway Company; Reply Report of Michael R. Baranowski |

*Circuit Court of Pulaski County, Arkansas*

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|---|---|
| August 17, 2007 | Case No. CV 2006-2711, Union Pacific Railroad v. Entergy Arkansas, Inc. and Entergy Services, Inc., Expert Witness Report of Michael R. Baranowski |
| December 14, 2007 | Case No. CV 2006-2711, Union Pacific Railroad v. Entergy Arkansas, Inc. and Entergy Services, Inc., Reply Expert Witness Report of Michael R. Baranowski |

*U.S. District Court for the Eastern District of Wisconsin*

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| February 15, 2008 | Case No. 06-C-0515, Wisconsin Electric Power Company v. Union Pacific Railroad Company, Expert Reply Report of Michael R. Baranowski |

*Arbitrations and Mediations*

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| March 7, 2005 | Arbitration Case #181 Y 00490 04 BNSF Railway Company and J.B. Hunt Transport, Inc., Expert Report on behalf of BNSF Railway Company |
| March 28, 2005 | Arbitration Case #181 Y 00490 04 BNSF Railway Company and J.B. Hunt Transport, Inc., Rebuttal Expert Report on behalf of BNSF Railway Company |
| April 12, 2005 | Arbitration Case #181 Y 00490 04 BNSF Railway Company and J.B. Hunt Transport, Inc., Supplemental Expert Report on behalf of BNSF Railway Company |
| April 19, 2005 | Arbitration Case #181 Y 00490 04 BNSF Railway Company and J.B. Hunt Transport, Inc., Supplemental Rebuttal Expert Report on behalf of BNSF Railway Company |
| April/May 2005 | Arbitration Case #181 Y 00490 04 BNSF Railway Company and J.B. Hunt Transport, Inc., Hearings before Arbitration Panel |
| February 20, 2007 | In the Matter of the Arbitration between the Detroit Edison Company, et al, and BNSF Railway Company, Expert Report of Michael R. Baranowski |

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| March 19, 2007 | In the Matter of the Arbitration between the Detroit Edison Company, et al, and BNSF Railway Company, Supplemental Expert Report of Michael R. Baranowski |
| February 12, 2009 | In the Matter of the Arbitration between Wisconsin Public Service Corporation and Union Pacific Railroad Company, Rebuttal Expert Report of Michael R. Baranowski |
| October 16, 2009 | In the Matter of Arbitration Between Norfolk Southern Railway Company and Drummond Coal Sales, Inc., Expert Report of Michael R. Baranowski |

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**Benton V. Fisher** is a Senior Managing Director of FTI's Economic Consulting group, located in Washington, D.C. Mr. Fisher has more than 20 years of experience in providing financial, economic and analytical consulting services to corporate clients dealing with transportation, telecommunications, and postal subjects.

North America's largest railroads have retained FTI both to assist them in making strategic and tactical decisions and to provide expert testimony in litigation. FTI's ability to present a thorough understanding of myriad competitive and regulatory factors has given its clients the necessary tools to implement and advance their business. Mr. Fisher has worked extensively to develop these clients' applications for mergers and acquisitions and expert testimony justifying the reasonableness of their rates before the Surface Transportation Board. In addition to analyzing extensive financial and operating data, Mr. Fisher has worked closely with people within many departments at the railroad as well as outside counsel to ensure that the railroads' presentations are accurate and defensible. Additionally, Mr. Fisher reviews the expert testimony of the railroads' opponents in these proceedings, and advises counsel on the necessary course of action to respond.

AT&T and MCI retained FTI to advance its efforts to implement the Telecommunications Act of 1996 in local exchange markets. Mr. Fisher was primarily responsible for reviewing the incumbent local exchange carriers' (ILEC) cost studies, which significantly impacted the ability of FTI's clients to access local markets. Mr. Fisher analyzed the sensitivity of multiple economic components and incorporated this information into various models being relied upon by the parties and regulators to determine the pricing of services. Mr. Fisher was also responsible for preparing testimony that critiqued alternative presentations.

Mr. Fisher assisted in reviewing the U.S. Postal Service's evidence and preparing expert testimony on behalf of interveners in Postal Rate and Fee Changes cases. He has also been retained by a large international consulting firm to provide statistical and econometric support in their preparation of a long-range implementation plan for improving telecommunications infrastructure in a European country.

Mr. Fisher has sponsored expert testimony in rate reasonableness proceedings before the Surface Transportation Board and in contract disputes in Federal Court and arbitration proceedings.

Mr. Fisher holds a B.S. in Engineering and Management Systems from Princeton University.

## TESTIMONY

*Surface Transportation Board*

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| January 15, 1999 | Docket No. 42022 FMC Corporation and FMC Wyoming Corporation v. Union Pacific Railroad Company, Opening Verified Statement of Christopher D. Kent and Benton V. Fisher |
| March 31, 1999 | Docket No. 42022 FMC Corporation and FMC Wyoming Corporation v. Union Pacific Railroad Company, Reply Verified Statement of Christopher D. Kent and Benton V. Fisher |
| April 30, 1999 | Docket No. 42022 FMC Corporation and FMC Wyoming Corporation v. Union Pacific Railroad Company, Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher |
| July 15, 1999 | Docket No. 42038 Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company, Opening Verified Statement of Christopher D. Kent and Benton V. Fisher |
| August 30, 1999 | Docket No. 42038 Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company, Reply Verified Statement of Christopher D Kent and Benton V Fisher |
| September 28, 1999 | Docket No 42038 Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company, Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher |
| June 15, 2000 | Docket No. 42051 Wisconsin Power and Light Company v. Union Pacific Railroad Company, Opening Verified Statement of Christopher D. Kent and Benton V. Fisher |
| August 14, 2000 | Docket No. 42051 Wisconsin Power and Light Company v. Union Pacific Railroad Company, Reply Verified Statement of Christopher D. Kent and Benton V. Fisher |
| September 28, 2000 | Docket No. 42051 Wisconsin Power and Light Company v. Union Pacific Railroad Company, Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher |
| December 14, 2000 | Docket No. 42054 PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Opening Verified Statement of Christopher D. Kent and Benton V. Fisher |
| March 13, 2001 | Docket No 42054 PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Christopher D. Kent and Benton V. Fisher |
| May 7, 2001 | Docket No. 42054 PPL Montana, LLC v. The Burlington Northern Santa Fe Railway Company, Rebuttal Verified Statement of Christopher D. Kent and Benton V. Fisher |

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| October 15, 2001 | Docket No. 42056 Texas Municipal Power Agency v. The Burlington Northern Santa Fe Railway Company, Opening Verified Statement of Benton V. Fisher |
| January 15, 2002 | Docket No. 42056 Texas Municipal Power Agency v. The Burlington Northern Santa Fe Railway Company, Reply Verified Statement of Benton V. Fisher |
| February 25, 2002 | Docket No. 42056 Texas Municipal Power Agency v. The Burlington Northern Santa Fe Railway Company, Rebuttal Verified Statement of Benton V. Fisher |
| May 24, 2002 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Opening Evidence and Argument of Norfolk Southern Railway Company |
| June 10, 2002 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Opening Evidence and Argument of Norfolk Southern Railway Company |
| July 19, 2002 | Northern States Power Company Minnesota v. Union Pacific Railroad Company, Union Pacific's Opening Evidence |
| September 30, 2002 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Reply Evidence and Argument of Norfolk Southern Railway Company |
| October 4, 2002 | Northern States Power Company Minnesota v. Union Pacific Railroad Company, Union Pacific's Reply Evidence |
| October 11, 2002 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Reply Evidence and Argument of Norfolk Southern Railway Company |
| November 1, 2002 | Northern States Power Company Minnesota v. Union Pacific Railroad Company, Union Pacific's Rebuttal Evidence |
| November 19, 2002 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Rebuttal Evidence and Argument of Norfolk Southern Railway Company |
| November 27, 2002 | Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Rebuttal Evidence and Argument of Norfolk Southern Railway Company |
| January 10, 2003 | Docket No. 42057 Public Service Company of Colorado D/B/A Xcel Energy v. The Burlington Northern and Santa Fe Railway Company, Opening Evidence and Argument of The Burlington Northern and Santa Fe Railway Company |
| February 7, 2003 | Docket No. 42058 Arizona Electric Power Cooperative, Inc. v The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad, Opening Evidence of The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad |

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| April 4, 2003 | Docket No. 42057 Public Service Company of Colorado D/B/A Xcel Energy v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence and Argument of The Burlington Northern and Santa Fe Railway Company |
| May 19, 2003 | Docket No. 42057 Public Service Company of Colorado D/B/A Xcel Energy v. The Burlington Northern and Santa Fe Railway Company, Rebuttal Evidence and Argument of The Burlington Northern and Santa Fe Railway Company |
| May 27, 2003 | Docket No. 42058 Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad, Joint Variable Cost Reply Evidence of The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad |
| May 27, 2003 | Docket No. 42058 Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad, Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| June 13, 2003 | Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Opening Evidence of The Burlington Northern and Santa Fe Railway Company |
| July 3, 2003 | Docket No. 42058 Arizona Electric Power Cooperative, Inc. v. The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad, Joint Variable Cost Rebuttal Evidence of The Burlington Northern and Santa Fe Railway Company and Union Pacific Railroad |
| October 8, 2003 | Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| October 24, 2003 | Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company Supplemental Evidence of Norfolk Southern Railway Company |
| October 31, 2003 | STB Docket No. 42069 Duke Energy Corporation v. Norfolk Southern Railway Company, Reply of Norfolk Southern Railway Company to Duke Energy Company's Supplemental Evidence |
| November 24, 2003 | STB Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Supplemental Evidence of Norfolk Southern Railway Company |
| December 2, 2003 | STB Docket No. 42072 Carolina Power & Light Company v. Norfolk Southern Railway Company, Reply of Norfolk Southern Railway Company to Carolina Power & Light Company's Supplemental Evidence |
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| March 1, 2004 | STB Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. The Burlington Northern and Santa Fe Railway Company, Opening Evidence and Argument of The Burlington Northern and Santa Fe Railway Company |
| March 22, 2004 | STB Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Supplemental Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| April 29, 2004 | STB Docket No. 42071 Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company, Rebuttal Evidence of The Burlington Northern and Santa Fe Railway Company |
| May 24, 2004 | STB Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. The Burlington Northern and Santa Fe Railway Company, Reply Evidence of The Burlington Northern and Santa Fe Railway Company |
| March 1, 2005 | Docket No. 42071 Otter Tail Power Company v BNSF Railway Company, Supplemental Evidence of BNSF Railway Company |
| April 4, 2005 | Docket No. 42071 Otter Tail Power Company v BNSF Railway Company, Reply of BNSF Railway Company to Supplemental Evidence |
| April 19, 2005 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Opening Evidence of BNSF Railway Company |
| July 20, 2005 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc v. BNSF Railway Company, Reply Evidence of BNSF Railway Company |
| July 27, 2004 | STB Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. The Burlington Northern and Santa Fe Railway Company, Rebuttal Evidence of The Burlington Northern and Santa Fe Railway Company |
| September 30, 2005 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Rebuttal Evidence of BNSF Railway Company |
| October 20, 2005 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Surrebuttal Evidence of BNSF Railway Company |
| June 15, 2006 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Reply Supplemental Evidence of BNSF Railway Company |
| June 15, 2006 | Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. BNSF Railway Company, Reply Supplemental Evidence of BNSF Railway Company |
| March 19, 2007 | Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. BNSF Railway Company, Reply Third Supplemental Evidence of BNSF Railway Company |

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| March 26, 2007 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Reply Second Supplemental Evidence of BNSF Railway Company |
| July 30, 2007 | Docket No. 42095 Kansas City Power & Light v. Union Pacific Railroad Company, Union Pacific's Opening Evidence |
| August 20, 2007 | Docket No. 42095 Kansas City Power & Light v. Union Pacific Railroad Company, Union Pacific's Reply Evidence |
| February 4, 2008 | Docket No. 42099 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Opening Evidence of CSXT |
| February 4, 2008 | Docket No. 42100 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Opening Evidence of CSXT |
| February 4, 2008 | Docket No. 42101 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Opening Evidence of CSXT |
| March 5, 2008 | Docket No. 42099 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Reply Evidence of CSXT |
| March 5, 2008 | Docket No. 42100 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Reply Evidence of CSXT |
| March 5, 2008 | Docket No. 42101 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Reply Evidence of CSXT |
| April 4, 2008 | Docket No. 42099 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Rebuttal Evidence of CSXT |
| April 4, 2008 | Docket No. 42100 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Rebuttal Evidence of CSXT |
| April 4, 2008 | Docket No. 42101 E.I. DuPont De Nemours and Company v. CSX Transportation, Inc., Rebuttal Evidence of CSXT |
| July 14, 2008 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Third Supplemental Reply Evidence of BNSF Railway Company |
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| September 5, 2008 | Docket No. 41191 (Sub-No. 1) AEP Texas North Company v. BNSF Railway Company, Fourth Supplemental Reply Evidence of BNSF Railway Company |
| October 17, 2008 | Docket No. 42110 Seminole Electric Cooperative, Inc. v. CSX Transportation, Inc , CSX Transportation, Inc.'s Reply to Petition for Injunctive Relief, Verified Statement of Benton V. Fisher |
| August 24, 2009 | Docket No. 42114 US Magnesium, L.L.C. v. Union Pacific Railroad Company, Opening Evidence of Union Pacific Railroad Company |

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| September 22, 2009 | Docket No. 42114 US Magnesium, L.L.C. v. Union Pacific Railroad Company, Reply Evidence of Union Pacific Railroad Company |
| October 22, 2009 | Docket No. 42114 US Magnesium, L.L.C. v. Union Pacific Railroad Company, Rebuttal Evidence of Union Pacific Railroad Company |
| January 19, 2010 | Docket No 42110 Seminole Electric Cooperative, Inc. v. CSX Transportation, Inc., Reply Evidence of CSX Transportation, Inc. |
| May 7, 2010 | Docket No. 42113 Arizona Electric Power Cooperative, Inc. v. BNSF Railway Company and Union Pacific Railroad Company, Joint Reply Evidence of BNSF Railway Company and Union Pacific Railroad Company |
| October 1, 2010 | Docket No. 42121 Total Petrochemicals USA, Inc. v. CSX Transportation, Inc., Motion for Expedited Determination of Jurisdiction Over Challenged Rates, Verified Statement of Benton V. Fisher |
| November 22, 2010 | Docket No. 42088 Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company, Comments of BNSF Railway Company on Remand, Joint Verified Statement of Michael R. Baranowski and Benton V. Fisher |
| January 6, 2011 | Docket No. 42056 Texas Municipal Power Agency v. BNSF Railway Company, BNSF Reply to TMPA Petition for Enforcement of Decision, Joint Verified Statement of Michael R. Baranowski and Benton V. Fisher |
| July 5, 2011 | Docket No. 42123 M&G Polymers USA, LLC v. CSX Transportation, Inc., Reply Market Dominance Evidence of CSX Transportation, Inc. |
| August 1, 2011 | Docket No. 42125 E.I. DuPont De Nemours and Company v. Norfolk Southern Railway Company, Norfolk Southern Railway's Reply to Second Motion to Compel, Joint Verified Statement of Benton V. Fisher and Michael Matelis |
| August 5, 2011 | Docket No. 42121 Total Petrochemicals USA, Inc. v. CSX Transportation, Inc. , Reply Market Dominance Evidence of CSX Transportation, Inc. |
| August 15, 2011 | Docket No. 42124 State of Montana v. BNSF Railway Company, BNSF Railway Company's Reply Evidence and Argument, Verified Statement of Benton V. Fisher |
| October 24, 2011 | Docket No. 42120 Cargill, Inc. v. BNSF Railway Company, BNSF Railway Company's Reply Evidence and Argument, Verified Statement of Benton V Fisher |

*U.S. District Court for the Eastern District of North Carolina*

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| March 17, 2006 | Civil Action No. 4:05-CV-55-D, PCS Phosphate Company v. Norfolk Southern Corporation and Norfolk Southern Railway Company, Report by Benton V. Fisher |

*U.S. District Court for the Eastern District of California*

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| January 18, 2010 | E.D. Cal. Case No. 08-CV-1086-AWI, BNSF Railway Company v. San Joaquin Valley Railroad Co., et al. |

*Arbitrations and Mediations*

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| July 10, 2009 | JAMS Ref. # 1220039135; In the Matter of the Arbitration Between Pacer International, Inc., d/b/a/ Pacer Stacktrain (f/k/a/ APL Land Transport Services, Inc.), American President Lines, Ltd. And APL Co. Pte. Ltd. And Union Pacific Railroad Company; Rebuttal Expert Report of Benton V. Fisher |

## *Effect of Transaction on BNSF's Variable Costs*

Following STB Conrail Approach, presented in Appendix N to 7/20/1998 Decision

*(Dollars in Millions)*

| | 2010, excluding PAA | Purchase Accounting Adj. | 2010 Year-End Balance 1/ | | Sources: |
|---|---|---|---|---|---|
| *Total* | | | | | |
| Net Investment | 33,404 | 12,651 | 46,055 | | R-1 Schedules 330 & 335 |
| Accum. Deferred Taxes | 10,022 | 4,507 | 14,528 | | BNSF workpapers |
| URCS Adj. Net Inv. Base | 23,382 | 8,144 | 31,527 | | |
| *Way & Structures* | | | | | |
| Net Investment | 27,945 | 12,441 | 40,386 | | R-1 Schedules 330 & 335 |
| Accum. Deferred Taxes | 8,384 | 4,432 | 12,816 | | Allocation |
| URCS Adj. Net Inv. Base | 19,561 | 8,009 | 27,570 | | |
| *Equipment* | | | | | |
| Net Investment | 5,459 | 210 | 5,669 | | R-1 Schedules 330 & 335 |
| Accum. Deferred Taxes | 1,638 | 75 | 1,713 | | Allocation |
| URCS Adj. Net Inv. Base | 3,821 | 135 | 3,956 | | |
| | | | | Pre-tax cost | |
| *Total* | | | | of capital 1/ | |
| W&S ROI | 3,208 | 1,314 | 4,522 | 16.4% | |
| Equipment ROI | 627 | 22 | 649 | | |
| *Variable* | | | | Variability 1/ | |
| W&S ROI | 1,604 | 657 | 2,261 | 50% | |
| Equipment ROI | 627 | 22 | 649 | 100% | |
| Total | 2,231 | **679** | 2,910 | | |
| *Variable Costs from 2010 URCS* | | | | | |
| Operating Expenses | | | 8,231 | | |
| Depreciation & Lease | | | 1,916 | | |
| ROI | | | 2,881 | | |
| Total | | | **13,028** | | |
| *PA Impact on Variable Costs* | | | | | |
| Dollars | 12,349 | **679** | 13,028 | | |
| % Increase | | **5.5%** | | | |

| | | | | |
|---|---|---|---|---|
| 1 *Including impact on annual depreciation expense:* | | | Variability 1/ | |
| Road Accounts | (89) | | 50% | BNSF workpapers |
| Equipment Accounts | (67) | | 100% | BNSF workpapers |
| Computer Systems | 217 | | 77% | BNSF workpapers |
| Total | 61 | | | |
| Variable Portion | **56** | | | |
| 2 *Including impact on annual fuel expense:* | (50) | | 95% | STB FSC reports |
| Variable Portion | **(48)** | | | |
| **Overall impact** | 12,341 | **687** | 13,028 | |
| | | **5.6%** | | |

1/ Based on R-1 report and preliminary 2010 URCS.

I declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on October 27, 2011

Benton V. Fisher

Benton V. Fisher

I declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on October 27, 2011

Michael R. Baranowski